Companies
The Energy Industry Turns on BP
p22

Politics
Sarkozy's Campaign Finance Scandale
p68

Social Media
Rise of the Corporate Tweeters
p64

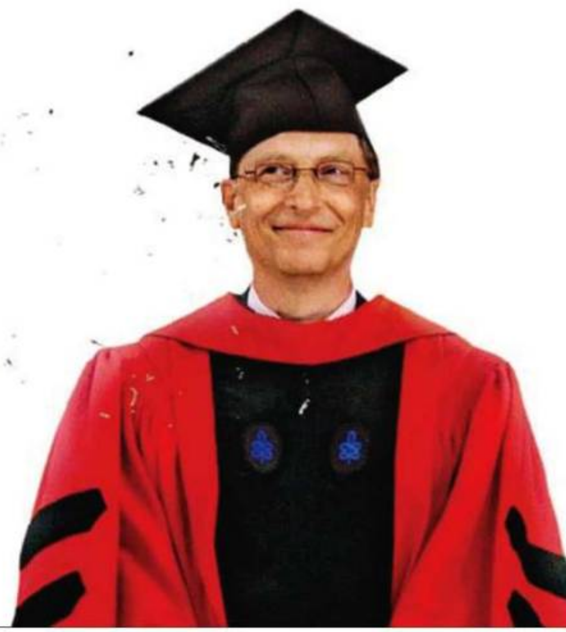


Plus

Battle Over the Bush Tax Cuts — p36
Hef Wants His Bunnies Back — p27
How Wal-Mart Won Chicago — p37
Baidu: Still Crushing Google — p39
The Perilous Office Fridge — p77

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Bloomberg Businessweek



The Bill & Melinda Gates Foundation has ______

- ○ Devoted $3 billion to fixing America's schools
- ○ Figured out how to fire bad teachers
- ○ The Secretary of Education in its pocket
- ○ No proven record on educational issues

Answer on p58





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Contents



Funky Fridges
A stomach-curdling report from the office lunchroom p77

Opening Remarks 7

The weak economy has some state politicians resorting to slippery accounting to balance their budgets. Here are a few honest ways to get their houses in order

Global Economics 13

A windfall for Germany
Despite voter ire at bailing out its neighbors, for Berlin, saving the euro is well worth the price

Singapore could grow faster than China this year p15
Japan's flight from the countryside p15
Reforming India's courts p16
Spotting emerging market entrepreneurs p20
Tom Keene's EconoChat p20

Companies & Industries 22

BP's Big Oil foes
The blame game goes on in the Gulf; now BP is being shunned by its own industry

Coke's World Cup song is a music and marketing hit p24
An early test for Alzheimer's p25
George Steinbrenner, 1930-2010 p26
Hunting Playboy bunnies p27
Discount air power in Asia p27
In Brief p28

Politics & Policy 31

GM's IPO: A tough sell
The automaker must persuade investors burned by the government takeover to buy in again

A bleak outlook for Dems p32
Rory (Reid) runs in Nevada p33
Charlie Rose/Valerie Jarrett p34
Medical pot, tax boon? p35
The Bush tax cuts battle p36
How Wal-Mart won Chicago p37

Technology 39

Google eats Baidu's dust
As the U.S. giant struggles in China, its Beijing-based rival is dominating the huge search market

Spotty reception for mobile companies in Africa p40
Finland's broadband plan p42
The Facebook suit and the ownership of an idea p42
A flying car. Really p43

Markets & Finance 44

Renters revive Miami
Price cuts are helping fill 7,000 unsold condos in the city's core, giving life to once-dark neighborhoods

Stressed over European stress tests p46
Tech stocks look cheap p47
A top fund manager gets back into banks p47
Goldman is IPO king p48
Bid & Ask: The week's deals p49

Retirement 51

Senior swindlers
More seniors are being lured into investment scams—and the elderly are often the scammers

Gen Y's empty piggy bank p52
Europe: Delaying retirement p53
William Bernstein on funding a comfortable retirement p54
Australia's art investment crackdown p55
Forget the 401(k) p56



Melinda and Bill Gates in Houston: A powerful force in U.S. education

Features 58

Bill Gates, Teachers' Pest
His foundation bets that report cards and the profit motive will work wonders in U.S. classrooms p58

Twitter, Twitter, Little Stars
Companies are rushing to hire social media directors—and figure out what they do p64

L'Affaire Sarkozy
What began as a fight among the family controlling L'Oréal has entangled the French President p68

How I Learned to Short the Euro
Are currency traders shameless speculators or essential to the gears of capitalism? p72

Etc. 77

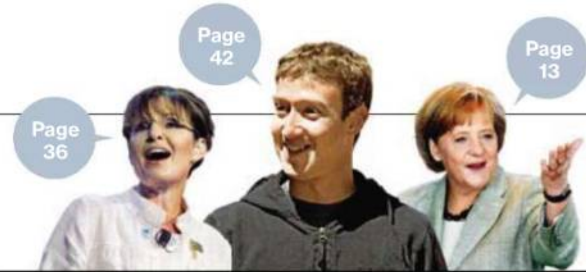
Welcome to Funkytown
With more workers eating at their desks, the recession has made the office fridge a toxic waste dump

One True Thing Office-appropriate shorts for steamy summer weather p80
Next Life A private equity player cashes out to grow money on) trees in Brazil p81
Navigator A personalized guide to seafaring vacations p82
Wealth Strategies for capitalizing on alternative assets in volatile times from high-net-worth financial adviser Louis Stanasolovich p84
The Stack In *The Zeroes*, publisher and Wall Street bard Randall Lane offers a gossipy recollection of a bloated decade and its ultrarich stars p85
Hard Choices Sungjoo Group founder and MCM Group chair Sung-Joo Kim on defying her family's wishes and becoming an entrepreneur p88

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Index



A

ABB Group (ABB) 13
ADC Telecommunications ADCT) 49
Ai 24
AirAsia 27
Air France-KLM Group 27
Alstom 13
A&M/Octone Records 24
Anadarko Petroleum (APC) 22
Analysys International 39
Aon (AON) 49
Apple (AAPL) 42, 52
AQR Managed Futures Strategy Fund (AQMNX) 84
Arbitrage Fund (ARBFX) 84
Attention! 64
AT&T (T) 64, 77
Avid Radiopharmaceuticals 25
Aviva 81
Avon (AVP) 49
Axiometrics 44

B

Baidu (BIDU) 39
Banco Santander (STD) 49
Bank of America (BAC) 49, 52
Bank of Japan 15
Barclays (BCS) 13, 47
Bayerische Landesbank 13
Bell, Marc 27
Bernstein, William 54
Bettencourt, Liliane 68
Bharti Airtel 40
Bisbal, David 24
Blessing, Martin 13
BMO Capital Markets 7
BMW 13, 28
BNP Paribas 15, 46
BP (BP) 22, 32
Brand Asset Group 24
Brevan Howard 72
Brewer, Jan 7
Broad, Eli 58
Buffett, Warren 58
Burberry 28
Burnham Financial Services (BURKX) 47
Burns, Ursula 34

C

Caldwell & Orkin Market Oppportunity Fund (COAGX) 84
Caxton Associates 72
CBS (CBS) 26
Ceglia, Paul 42Charles Schwab (SCHW) 52
China Life (LFC) 28
China Pacific Insurance 28
Christie, Chris 7
Chu, Steven 33
CIMB Research 15
Citigroup (C) 15, 49, 64
Clinton, Hillary 32
Coca-Cola (KO) 24
Cohen, Steve 85
Colliers International 44
Commerzbank 13
ConAgra (CAG) 77
Condo Vultures 44
Costco (COST) 85
Craig-Hallum Capital Group 31
Credit Suisse (CS) 39, 46, 48

D

Daesung Group 88
de Jager, Jan Kees 46
Dell (DELL) 64
Deloitte 44
Deutsche Bank (DB) 13, 46
Devon Energy (DVN) 22
Dietrich, Carl 43
Dominick's 37
Donohue, Tom 34
Douglas, Jim 7
Druckenmiller, Stanley 72
Duncan, Arne 58
du Pont, Pierre S. 58
Dykstra, Lenny 85

E

Eaton Vance Global Macro Absolute Return Fund (EAGMX) 84
Eisai 25
Electronic Arts (ERTS) 64
Ellison, David 47
European Central Bank 13
ExxonMobil (XOM) 22

F

Facebook 42, 52, 64
FBR Capital Markets 47
F&C Asset Management 46
FedEx (FDX) 64
Feinstein, Dianne 35
Feldstein, Martin 13
Ferguson, Niall 20
Fidelity Investments 47, 52
Fifth Third Bank (FITB) 64
Fiji Water 64
Financial Engines 48
Fitch Ratings 40
Flanders, Scott 27
Ford (F) 31, 64
France Telecom (FTE) 40
FriendFinder Networks 27

G

Gallup 56
Gandhi, Natwar 7
Gates, Bill 58
Gates, Melinda 58
General Electric (GE) 13, 25
Genting Singapore 15
Ghana Telecommunications 40
GlaxoSmithKline (GSK) 15, 28
GM 31
GoDaddy.com 64
Goldman Sachs (GS) 15, 28, 48
Google (GOOG) 39, 77
Grantham, Jeremy 47
Green Giraffe 40
Greenspan, Alan 72
Gucci 88

H

Hackett, James T. 22
Hefner, Hugh 27
Hewitt Associates (HEW) 49
Honda (HMC) 64
Hornbeck Offshore Services 22
Hulu 39, 42

I

ICICI Bank (BN) 16
ING Bank (ING) 46
ING Group (ING) 13
Intel (INTC) 28
Itaú Unibanco 28

J

James, LeBron 44
Jarrett, Valerie 34
Jewel 37
Jones, Paul Tudor 72
JPMorgan Chase (JPM) 31, 48
Jupp, Brad 58

K

Kim, Sung-Joo 88
Kiviniemi, Mari 42
Kovner, Bruce 72
Kurz, Howard 72

L

Las Vegas Sands (LVS) 15
Law, Andrew 72
Lehman Brothers 72
Lewis, Michael 85
Lily Pond Capital Management 72
Li, Robin 39
L'Oréal 68

M

Macquarie Group 15
Malaysia Airlines 27
Manning, Eli 85
Marks & Spencer 88
Mashable 64
McDonald's (MCD) 64
McNerney, Jim 34
MCM Group 88
Meetup 64
Merger Fund (MERFX) 84
Merkel, Angela 13
MetLife (MET) 51
MGM Resorts International (MGM) 33
Microsoft (MSFT) 42, 58
Mitsui Oil Exploration 22
Mohamad, Mahathir 72
Moore Capital 72
Morgan Stanley (MS) 13, 31
Morningstar (MORN) 47
MTN Group 40

N

NBC Universal 42
Nestlé 68
News Corp. (NWS) 43
Nokia (NOK) 39
Nomura 46

O

Obama, Barack 33
Ogilvy & Mather 64
Oppenheimer & Co. 39
Orneberg, Harald 81
Oxygen Media 40

P

Palin, Sarah 36
Panasonic (PC) 64
Papandreou, George 72
Paterson, David 7
Patrick, Deval 7
PepsiCo (PEP) 77
Petco 64
Pfizer (PFE) 15, 25
Philip Morris 35
Phillips, Vicki 58
Playboy Enterprises (PLA) 27
Providence Equity Partners 39

Q R

Qantas Airways 27
Quinn, Patrick 7
Ravitch, Diane 58
Ravitch, Richard 7
RBS (RBS) 39, 49
Rehn, Olli 46
Reid, Harry 33
Reid, Rory 33
Related Group 44
Renaissance Technologies 85
Reynders, Didier 46
Rizvi Traverse Management 27
Robertson, Julian 58
Roche 15
Rodriguez, Robert 47
Rogers, Margot 58
Royal Dutch Shell (RDSA) 22
Ryanair (RYAAY) 27
Rydex/SGI Managed Futures Strategy Fund (RYMTX) 84

S

SAC Capital Advisors 85
Salazar, Ken 33
Sandoval, Brian 33
Sanofi-aventis (SNY) 15
Sarkozy, Nicolas 68
Schwarzenegger, Arnold 7
Scientia Advisors 25
Sears Holdings (SHLD) 64
Seidenberg, Ivan 34
Selzer 32
Sharpe, William 48
SharesPost 42
Shelton, James H. III 58
Siemens (SI) 13, 25
Silpada Designs 49
Simons, James 85
Sina (SINA) 39
Singapore Airlines 27
Singh, Manmohan 16
Skovronsky, Daniel 25
Smith Asset Management 31
Société Générale 46
Soros, George 13, 72
Sotheby's (BID) 49
Southwest Airlines (LUV) 27
Standard Bank 20
Steinbrenner, George 26
Sungjoo Group 88

T

Teal Group 43
TeliaSonera 42
Tencent 39
Terrafugia 43
Tesla (TSLA) 42
The Forest Company 81
Torre, Joe 26
Towers Perin 49
Travolta, John 85
Trumka, Richard L. 18
Tudor Investment 72
Turner, Kevin 42
Twitter 52, 64
Tyco Electronics (TEL) 49

U

UBS (UBS) 47
Ultimate Fighting Championship 64
United Airlines (UAUA) 64
UOB Kay Hian Research 27

V

Vanguard 52, 54
Vanhanen, Matti 42
Verizon (VZ) 34
Vinovskis, Maris A. 58
Violator Management 24
Visa (V) 31
Vivendi 24
Vodafone (VOD) 40

W

Wal-Mart Stores (WMT) 37, 58
Watson Wyatt 49
Weckström, Juha-Pekka 42
Weingarten, Randi 58
Wells Fargo (WFC) 47
WestLB Mellon Asset Management 13
Weyerhaeuser (WY) 49
Whitacre, Edward 31
Whole Foods Market (WFMI) 52
will.i.am 24
Woerth, Eric 68

Y

YouTube (GOOG) 64

Z

Zain Group 40
Zuckerberg, Mark 42

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Opening Remarks



California has used one-shot fixes to help close its budget gap

States of Crisis

Governors know plenty of phony ways to balance out-of-whack state budgets. Here are a few honest ones. By Peter Coy

As the weak economy punishes state budgets, it is driving some politicians to take refuge in almost hallucinatory forms of accounting. Unable to pay vendors, Illinois piled up a $5 billion mountain of IOUs. California Republican Governor Arnold Schwarzenegger warned 200,000 state employees he might temporarily have to cut their pay to minimum wage. And New York, whose fiscal year began on Apr. 1, is limping along without a budget because warring parties are using the negotiating tactic called "delay until you get your way." New York Democratic Governor David Paterson says he almost feels like moving to Vermont. "I think I might just walk over there and see if they'd like me to stay," Paterson joked to a Bloomberg News reporter on July 10 during a break at the National Governors Assn. meeting in Boston.

Crisis needn't breed cravenness. Some state lawmakers are using the mess as an opportunity, a chance to ram through reforms to help fix the structural budget imbalances that, if left unaddressed, will plague them for decades to come. New Jersey Republican Governor Chris Christie has forced the state's unionized teachers, for the first time, to pay for part of their health-care coverage. Indiana cut the cost of a prison meal from $1.43 to 99¢ by contracting out the job. Last year Massachusetts Democratic Governor Deval Patrick signed a cost-saving law permitting the use of civilian flaggers for road work, ending the state's status as the only one requiring uniformed police officers at all road construction sites.

As Supreme Court Justice Louis Brandeis wrote in a 1932 opinion, states can "try novel social and economic experiments without risk to the rest of the country." Economists predict several more years of stress, even though states' tax revenue ticked up in the first quarter of 2010 from a year earlier, according to the Nelson A. Rockefeller Institute of Government. So there's plenty of time for wayward pols to adopt the wisdom of responsible ones. "We've got to fundamentally rethink how we do things and not just go through traditional budget-cutting," says Vermont Republican Governor Jim Douglas, former chairman of the National Governors Assn.

Of course, the fiscal crisis is not a political-science experiment. Deficit-closing measures are cutting into the meat and bone of social programs, pushing up taxes on people already whacked by the weak economy, or both. Hard as it is, though, states have no choice but to bring their budgets into balance—and not just through fiscal legerdemain. Governors have long been adept at one-shot tricks to balance operating budgets, as all states but Vermont require. That goes even for states that are doing some things right: This past fiscal year, Arizona sold off about $1 billion worth of real estate, including the state Capitol and the state Supreme Court. New Jersey is skipping a $3 billion pension contribution even though state plans were underfunded by $46 billion as of a year ago.

Such maneuvers may be hard to avoid, but they don't fool the markets. According to investors in credit default swaps, an insurance-like derivative, as of July 13, Illinois and Cali-

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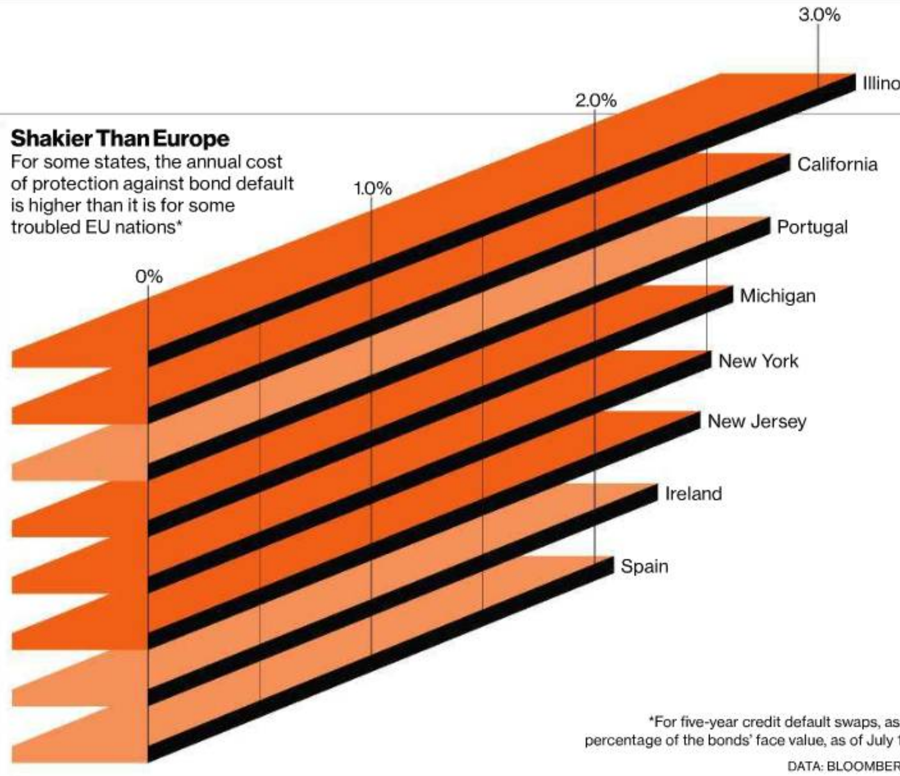
fornia are greater credit risks than Portugal. Michigan, New York, and New Jersey are deemed a bit better than Portugal but still chancier than Ireland and Spain, indebted weaklings of the single-currency euro zone. High borrowing costs worsen states' financial plight and increase the risk they could be cut off from credit altogether.

States don't have a chance of getting their houses in order unless they tackle unaffordably generous pension and health-care benefits for public employees. Addressing a special session of the New Jersey legislature in February, Christie related an entitlements horror story: "A retired teacher paid $62,000 towards her pension and nothing, yes nothing, for full family medical, dental, and vision coverage over her entire career. What will we pay her? $1.4 million in pension benefits and another $215,000 in health-care benefit premiums over her lifetime." Spokesman Steve Baker of the New Jersey Education Assn. says that's far more than what most teachers get. But Christie's larger point is inarguable. Budgetary reform is long overdue. How to get started on the kind that will last? Here are some lessons from the states:

Don't Just 'Starve The Beast' There's no guarantee that simply depriving states of adequate revenue—a conservative tactic dating back to Ronald Reagan—will produce the streamlined budgets everyone wants. It's just as likely that states will cut programs that are valuable but politically uninsulated, or raise money in regressive ways, like gambling. Arizona reduced assistance for 17,000 seriously mentally ill people in the new fiscal year. Cash-strapped California has scheduled a November ballot initiative on marijuana legalization: The state's tax collector estimated last year that fully legalizing consumption could generate $1.4 billion a year in state and local taxes (page 35). "No one's clean. No one's pure," says George Mason University Professor Paul Posner.

Apply Targeted Pressure In New Jersey, Christie decided that the worst overspending was on municipal and school-district personnel. But those were outside of his jurisdiction. So he took his case to the voters, urging them to reject school budgets unless teachers accepted a salary freeze. Only about two dozen of the 500 or so teacher bargaining units went along with the freeze—and then a record 59 percent of school districts saw their budgets voted down. The ballot-box defeats forced school districts to slash teacher jobs, sending the union a message that Christie was a force to be reckoned with.

Shakier Than Europe
For some states, the annual cost of protection against bond default is higher than it is for some troubled EU nations*



*For five-year credit default swaps, as a percentage of the bonds' face value, as of July 13

DATA: BLOOMBERG

Prepare for Total War The more ambitious the reform, the stronger the resistance. California's Schwarzenegger was unable to overcome opposition from the Democrat-controlled legislature and fell short of his smaller-government objectives. Illinois Democratic Governor Pat Quinn started out playing hardball this year but ended up settling for a budget that calls for nearly $10 billion in borrowing to pay vendors and make pension contributions. Colorado Democratic Governor Bill Ritter, who is not seeking reelection, showed more gumption when he resisted lawmakers' calls to restore spending because of a small, unexpected improvement in revenue.

Raise Taxes (Sometimes) With anti-tax sentiment running strong, state politicians have tried to keep tax hikes to a minimum and to rely mainly on spending cuts to balance budgets. That's probably the right call in high-tax states with bloated spending like New York and New Jersey. But it's harder to justify in low-tax states like Arizona. There, Governor Jan Brewer bragged in January that her state's tax burden as a share of personal income was the lowest in more than 30 years. Nevertheless, she sought to close a fiscal 2011 funding gap mainly through one-time measures and spending cuts. Brewer did get a temporary penny increase in the sales tax—along with her deep spending cuts. An allergy to taxes may seem business-friendly, but even many bond investors favor tax hikes as part of a budget-balancing when complete reliance on spending cuts or gimmicks is unsustainable, says Justin Hoogendoorn, a bond strategist at BMO Capital Markets in Chicago.

Tie Your Hands States need to set up a mechanism that will tame their own worst instincts—that is, prevent them from caving in to special interests and overspending once the crisis eases. New York Lieutenant Governor Richard Ravitch is proposing an independent review board that would issue quarterly reports on whether the state was making "adequate progress" toward permanent budget balance. If not, the governor would have authority to make across-the-board cuts. That's similar to the oversight mechanism Ravitch and others used to bring New York City back from a near-death experience in the 1970s. It's also similar to the system Washington, D.C., has used to improve its credit rating since the late 1990s. The District of Columbia's watchdog, Chief Financial Officer Natwar Gandhi, is free to speak his mind because if the mayor fires him, Congress can reinstate him. If each of the 50 states had its own Gandhi, the fiscal storm clouds might already be showing signs of clearing.

—With Michael McDonald, Terrence Dopp, William Selway, and Esmé E. Deprez

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No studies have shown a reduction in the risk of heart disease with ACTOS or any other antidiabetic drug.

ACTOS is not for everyone. Please see the **Important Safety Information** below, including **warning about heart failure**.

Ask your doctor if ACTOS is right for you.

Important Safety Information

ACTOS is not for everyone. Certain patients with heart failure should not start taking ACTOS. ACTOS can cause new, or worsen, heart failure. Talk to your doctor immediately if you experience unusually fast weight gain, fluid retention (swelling), shortness of breath, or unusual tiredness.

ACTOS is not for patients with type 1 "juvenile" diabetes or diabetic ketoacidosis.

ACTOS may cause low blood sugar when taken in combination with insulin or sulfonylureas. Lightheadedness, shakiness, dizziness, or hunger, may mean that your blood sugar is too low. Talk to your doctor if low blood sugar is a problem for you.

Some people taking ACTOS may experience flulike symptoms, mild-to-moderate swelling of legs and ankles, anemia, and weight gain.

If you are of childbearing age, talk to your doctor before taking ACTOS, as it could increase your chance of becoming pregnant. Talk to your doctor if you are pregnant, planning to become pregnant, breastfeeding, or planning to breastfeed.

Do not take ACTOS if you have active liver disease. Your doctor should perform a blood test to check for liver problems before you start ACTOS and periodically thereafter. Talk to your doctor immediately if you experience nausea, vomiting, stomach pain, unusual tiredness, loss of appetite, dark urine, or yellowing of the skin or eyes.

Patients with diabetes should have regular eye exams. If you experience vision problems, consult your doctor immediately. Some patients have experienced visual changes while taking ACTOS.

Some people, particularly women, are at higher risk of having bone fractures while taking ACTOS.

Other side effects may include cold-like symptoms, headache, sinus infection, muscle pain, tooth disorder, and sore throat.

ACTOS has not been studied in children and is not recommended for children under the age of 18.

You are encouraged to report negative side effects of prescription drugs to the FDA. Visit www.fda.gov/medwatch or call 1-800-FDA-1088.

Please see the accompanying Brief Summary (Medication Guide) of the Complete Prescribing Information on adjacent page.

*IMS Health, NPA™, July 24, 2009.

IF YOU HAVE QUESTIONS ABOUT ACTOS, PLEASE TALK TO YOUR DOCTOR OR VISIT WWW.ACTOS.COM.

Takeda

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pioglitazone HCl

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MEDICATION GUIDE
ACTOS® (ak-TŌS)
(pioglitazone hydrochloride) tablets

Read this Medication Guide carefully before you start taking ACTOS and each time you get a refill. There may be new information. This information does not take the place of talking with your doctor about your medical condition or your treatment. If you have any questions about ACTOS, ask your doctor or pharmacist.

What is the most important information I should know about ACTOS?
ACTOS can cause serious side effects, including **new or worse heart failure.**

- ACTOS can cause your body to keep extra fluid (fluid retention), which leads to swelling (edema) and weight gain. Extra body fluid can make some heart problems worse or lead to heart failure. Heart failure means your heart does not pump blood well enough.
- If you have severe heart failure, you cannot start ACTOS.
- If you have heart failure with symptoms (such as shortness of breath or swelling), even if these symptoms are not severe, ACTOS may not be right for you.

Call your doctor right away if you have any of the following:

- swelling or fluid retention, especially in the ankles or legs.
- shortness of breath or trouble breathing, especially when you lie down.
- an unusually fast increase in weight.
- unusual tiredness.

ACTOS can have other serious side effects. See "What are the possible side effects of ACTOS?"

What is ACTOS?
ACTOS is a prescription medicine used with diet and exercise to improve blood sugar (glucose) control in adults with type 2 diabetes. ACTOS is a diabetes medicine called pioglitazone hydrochloride that may be taken alone or with other diabetes medicines.

Your doctor will decide if you should take ACTOS.

It is important to eat the right foods, lose weight if needed, and exercise regularly in order to manage your type 2 diabetes. Diet, weight loss, and exercise are the main treatments for type 2 diabetes and they also help your diabetes medicines work better for you.

ACTOS has not been studied in children and is not recommended for children under the age of 18. The risks of giving ACTOS to a child are not known. See "What are some other possible side effects of ACTOS?"

Who should not take ACTOS?
Do not take ACTOS if you:

- are allergic to any of the ingredients in ACTOS. See the end of this Medication Guide for a complete list of ingredients in ACTOS.

People with severe heart failure should not start taking ACTOS. See "What is the most important information I should know about ACTOS?"

What should I tell my doctor before taking ACTOS?
Before starting ACTOS, ask your doctor about what the choices are for diabetes medicines and what the expected benefits and possible risks are for you in particular.

Tell your doctor about all of your medical conditions, especially if you:

- **have heart failure.**
- **have type 1 ("juvenile") diabetes or had diabetic ketoacidosis.** These conditions should be treated with insulin.
- **have a type of diabetic eye disease called macular edema** (swelling of the back of the eye).
- **have liver problems.** Your doctor should do blood tests to check your liver before you start taking ACTOS and during treatment as needed.
- **are pregnant or planning to become pregnant.** Actos should not be used during pregnancy. It is not known if ACTOS can harm your unborn baby. Talk to your doctor about the best way to control your blood glucose levels while pregnant.
- **are a premenopausal woman (before the "change of life"), who does not have periods regularly or at all.** ACTOS may increase your chance of becoming pregnant. Talk to your doctor about birth control choices while taking ACTOS. Tell your doctor right away if you become pregnant while taking ACTOS.
- **are breastfeeding or plan to breastfeed.** It is not known if ACTOS passes into your milk and if it can harm your baby. You should not take ACTOS if you breastfeed your baby. Talk to your doctor about the best way to control your blood glucose levels while breastfeeding.

Tell your doctor about all the medicines you take including prescription and non-prescription medicines, vitamins, and herbal supplements. ACTOS and some of your other medicines can affect each other. You may need to have your dose of ACTOS or certain other medicines adjusted. Certain other medicines can affect your blood sugar (glucose) control.

Know the medicines you take. Keep a list of your medicines and show it to your doctor and pharmacist before you start a new medicine. They will tell you if it is okay to take ACTOS with other medicines.

How should I take ACTOS?

- Take ACTOS exactly as prescribed.
- Your doctor may need to change your dose of ACTOS to control your blood glucose. Do not change your dose unless told to do so by your doctor.
- ACTOS may be prescribed alone or with other diabetes medicines. This will depend on how well your blood sugar is controlled.
- Take ACTOS one time each day, with or without food.
- If you miss a dose of ACTOS, take your next dose as prescribed unless your doctor tells you differently. Do not take two doses at one time the next day.
- If you take too much ACTOS, call your doctor or poison control center right away.
- If your body is under stress, for example: due to fever, infection, trauma (such as a car accident), or surgery, the dose of your diabetes medicines may need to be changed. Call your doctor right away.
- Stay on your diet and exercise programs and test your blood sugar regularly while taking ACTOS.
- Your doctor should do blood tests before starting ACTOS and from time to time to check your liver, kidneys, and blood cells.
- Your doctor should also do regular blood tests (for example, hemoglobin A1C) to check how well your blood sugar is controlled with ACTOS.
- Your doctor should check your eyes regularly. Some people have had vision changes due to swelling in the back of the eye, called macular edema, while taking ACTOS.
- It may take 2-3 months to see the full effect on your blood sugar level.

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What are other possible side effects of ACTOS?
ACTOS can cause other serious side effects including:

- **Weight gain.** Pioglitazone, the medicine in ACTOS can cause weight gain that may be due to fluid retention or extra body fat. Weight gain due to fluid retention can be a serious problem for people with certain conditions, including heart problems. See "What is the most important information I should know about ACTOS?".
- **Liver problems**. It is important for your liver to be working normally when you take ACTOS. Your doctor should do blood tests to check your liver before you start taking ACTOS and during treatment as needed. Call your doctor right away if you have unexplained symptoms such as:
  - nausea or vomiting.
  - stomach pain.
  - unusual or unexplained tiredness.
  - loss of appetite.
  - dark urine.
  - yellowing of your skin or the whites of your eyes.
- **Macular edema** (diabetic eye disease with swelling in the back of the eye). Tell your doctor right away if you have any changes in your vision. Your doctor should check your eyes regularly.
- **Fractures (broken bones),** usually in the hand, upper arm, or foot in women. Talk to your doctor for advice on how to keep your bones healthy. It is not known if ACTOS can affect the bones of children.
- **Low red blood cell count (anemia).**
- **Low blood sugar (hypoglycemia).** Lightheadedness, dizziness, shakiness, or hunger may indicate that your blood sugar is too low. This can happen if you skip meals, if you use another medicine that lowers blood sugar, or if you have certain medical problems. Call your doctor if low blood sugar levels are a problem for you.
- **Ovulation** (release of an egg from an ovary in a woman) leading to pregnancy. Ovulation may happen when premenopausal women who do not have regular monthly periods take ACTOS. This can increase the chance of pregnancy. See "What should I tell my doctor before taking ACTOS?".

In studies of pioglitazone (the medicine in ACTOS), bladder cancer occurred in a few more people who were taking pioglitazone than in people who were taking other diabetes medicines. There were too few cases to know if the bladder cancer was related to pioglitazone.

Other common side effects of ACTOS are:

- cold-like symptoms (respiratory tract infection),
- headache,
- sinus infection,
- muscle pain,
- tooth disorder,
- sore throat.

Tell your doctor if you have any side effect that bothers you or that does not go away. These are not all the side effects of ACTOS. For more information, ask your doctor or pharmacist.

Call your doctor for medical advice about side effects. You may report side effects to FDA at 1-800-FDA-1088.

How should I store ACTOS?

- Store ACTOS at 59° to 86°F (15° to 30°C). Keep ACTOS in the original container to protect from light.
- Keep the ACTOS bottle tightly closed and protect from getting wet (away from moisture and humidity).

Keep ACTOS and all medicines out of the reach of children.

General information about ACTOS
Medicines are sometimes prescribed for purposes other than those listed in a Medication Guide. Do not use ACTOS for a condition for which it is not prescribed. Do not give ACTOS to other people, even if they have the same symptoms you have. It may harm them.

This Medication Guide summarizes the most important information about ACTOS. If you would like more information, talk with your doctor. You can ask your doctor or pharmacist for information about ACTOS that is written for healthcare professionals. For more information, go to www.actos.com or call 1-877-825-3327.

What are the ingredients in ACTOS?
Active Ingredient: pioglitazone hydrochloride
Inactive Ingredients: lactose monohydrate, hydroxypropylcellulose, carboxymethylcellulose calcium, and magnesium stearate.

Always check to make sure that the medicine you are taking is the correct one. ACTOS tablets look like this:

- 15 mg strength tablets – white to off-white, round, convex, non-scored with "ACTOS" on one side, and "15" on the other.
- 30 mg strength tablets – white to off-white, round, flat, non-scored with "ACTOS" on one side, and "30" on the other.
- 45 mg strength tablets – white to off-white, round, flat, non-scored with "ACTOS" on one side, and "45" on the other.

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This Medication Guide has been approved by the U.S. Food and Drug Administration.

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M001-01

L-PIO-0909-5

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More phones that work in
more countries, like China.

att.com/global

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Contents ▶ Singapore may outpace China 15 ▶ Why Japan's provinces are withering away 15 ▶ Freeing India's courts from red tape 16 ▶ China exposure 18 ▶ A test to spot developing world entrepreneurs 20 ▶ Tom Keene talks to Harvard's Niall Ferguson about Europe's banks 20 ● Edited by Christopher Power

Global Economics



Outbound VWs: The euro's fall is fueling German exports

CHRISTIAN CHARISIUS/REUTERS

Germany Reaps The Euro's Reward

▶ **Despite voters' anger, the country's businesses have benefited from the common currency**

▶ **"A breakup [of the euro] would be a big, big problem for the German economy"**

Many German voters have balked at the cost of rescuing Greece and, by extension, the euro. Better, they argue, to return to the old deutsche mark and have thrifty Germany stand on its own than stick with the failed experiment of monetary union, especially union with undisciplined players like Greece, Spain, and Portugal.

Yet rising share prices and foreign sales at such German blue chips as **BMW** and **Siemens** show why it may be worth keeping the single currency even as voters complain. The overall drop in the euro this year has given German exports a nice boost by making them cheaper. Moreover, the introduction of the euro in 1999 forced German companies long ago to lower labor costs and become even more competitive.

The payoff from all this pain is clear: German unemployment has dropped to 7.7 percent, near an 18-year low, and the DAX, up more than 4 percent since January, is the euro zone's best-performing major stock index this year. "Talking to companies, you get the feeling that they are really quite positive about their earnings and expectations," says Stefan Moeckel, a fund manager at WestLB Mellon Asset Management in Düsseldorf, which oversees some $50 billion. He says the DAX may reach 7,000 by yearend, compared with its mid-July level of around 6,200. And on July 8, **Commerzbank** Chief Executive Officer Martin Blessing said Germany is growing faster than anticipated. **Deutsche Bank** predicts the country's economy will expand 2 percent this year, greater than France, Italy, and Spain.

German unemployment is near an 18-year low, and the stock index is the euro zone's strongest this year

This powerful performance is reinforcing Germany's status as a pillar of euro stability just as European policymakers are scrambling to keep the region from lurching back into recession. While academics such as Harvard economics professor Martin Feldstein say the Greek crisis could yet splinter the euro, and investor George

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Global Economics

Soros urges Germany to do more to ease economic tensions in the region and save monetary union, the euro is rebounding, revived in part by Germany's strong showing. The currency has gained 7 percent against the dollar since hitting a four-year low of $1.19 to the greenback on June 7.

Germany has had some tough moments in the last 20 years. First, the huge costs of reunification with a decrepit East Germany were a drain on the economy. (Detractors labeled the country the "sick man of Europe.") Then came the launch of the euro. With the common currency preventing governments from devaluing their way to growth, Germany had to squeeze labor costs to boost productivity and regain its competitive edge. Other euro zone countries, including Spain and Greece, opted instead to accept generous pay raises for their workforces to stimulate their economies in the new age of monetary union.

The result has sharpened Germany's advantage over the southern periphery of the euro region. By 2009, Europe's largest economy had grown 13 percent more competitive than its neighbors since 1998, mirroring similar-sized declines in Spain and Greece, according to a metric based on labor costs that was designed by the European Central Bank. To take one example, Munich-based Siemens, the Continent's largest engineering company, has recorded $29 billion in restructuring costs since 2001, according to estimates by Morgan Stanley. That new efficiency made it much easier for Siemens to compete in a crowded regional market. The European share of Siemens' sales reached 41 percent in 2009, up from 32 percent in 2004. Its operating margin has climbed above those of General Electric, French conglomerate Alstom, and Swiss-based giant ABB Group.

Euro membership has also sheltered Germany from the ravages of the global financial crisis–the country relies on exports for 41 percent of its gross domestic product. Prior to the euro's introduction, the mark was a haven in times of turmoil and thus prone to volatility, surging about 50 percent against the slumping Italian lira in the first half of the 1990s. "The deutsche mark would have appreciated massively as a result of the financial crisis, harming German exports and making the 2009 recession much worse," says Juergen Pfister, chief economist at Munich-based lender Bayerische Landesbank.


Chancellor Merkel at a special budget meeting of her Cabinet in June

Such thinking convinces many economists that Germany should stay in the euro zone for its own sake and Europe's. "A breakup would be a big, big problem for the German economy, probably bigger than for most others," says Julian Callow, chief European economist at Barclays Capital in London. Mark Cliffe, chief economist for ING Group, calculates that any splintering of the euro would spark such a crisis of confidence in Europe that demand would plummet. That would trigger a slump in German output of about 10 percent over two years, he figures.

While German business clearly sees the benefits of sticking with the euro, voters remain angry that the country is footing the biggest share of the bailouts agreed to by leaders earlier this year. Fifty-one percent of respondents in a poll published on June 30 by the tabloid *Bild* called for a return to the deutsche mark. That's up from a third in March 2008.

Ordinary Germans are angry that of the $775 billion pledged by governments as an emergency reserve for euro zone countries to tap, Germany could be on the hook for as much $216 billion. Nonetheless, Joerg Kraemer, chief economist at Commerzbank in Frankfurt, says quitting the euro is "not on the agenda" for the government of Chancellor Angela Merkel. In contrast, Morgan Stanley's co-chief global economist, Joachim Fels, has said that could change. If investors start to question other euro zone governments' commitment to fiscal discipline and again drive up the cost of borrowing, German policymakers may rethink the advantages of membership, says Fels. A German exit from the euro is "clearly not a near-term possibility," he told Bloomberg TV on May 18. "It is a distinct possibility longer-term."



That long-term scenario doesn't have to happen if German business can keep spreading the benefits of its latest success to the rest of the nation. Already, the export boom has translated into falling unemployment. Should the jobless rate drop further, German voters may yet see the advantages of staying with the currency that gave

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their country an edge in competing around the world. "We are the winner because of [our] high exports," says Christa Randzio-Plath, former chairwoman of the European Parliament's monetary affairs committee and now a professor at the University of Hamburg. "We would pay for going out of the euro area." —*Simon Kennedy*

The bottom line *Ordinary Germans scorn the euro because of the Greek crisis, while German business has benefited greatly from monetary union.*

FROM LEFT: MICHAEL SOHN/AP PHOTO; EDGAR SU/REUTERS



The Marina Bay Sands: 3 million have visited Singapore's casinos

Asia

A New Growth Champ? It Might Be Singapore

▶ **The city-state's economy could grow faster than China's this year**

▶ **Pharma and casinos provide a boost—for the first half at least**

Singapore's economy grew at an annualized rate of 26 percent in the second quarter, a blistering pace that may moderate for the full year to 15 percent, the top-of-the-range estimate for many economists. That should be enough to overtake China as Asia's fastest-growing economy this year, increasing the attractiveness of the city-state's stocks and putting pressure on policymakers to check inflation with a stronger currency.

Even as **Goldman Sachs**, **BNP Paribas**, and **Macquarie Group** have cut 2010 growth estimates for China to at most 10.1 percent in recent weeks, Singapore has surprised investors recently with its vigor. A long-standing policy to lure pharmaceutical factories to Singapore with tax breaks, special research and development facilities, and worker training has paid off spectacularly. **Pfizer**, **Sanofi-aventis**, **Roche**, and other drug giants have picked Singapore as a key operations base for Asia because they need facilities that can pass rigorous inspections by regulators and produce huge volumes of pharmaceuticals. Pfizer, Roche, and **GlaxoSmithKline** have all expanded in Singapore this year.

The city-state has also dropped a 45-year ban on gambling in a drive to double tourism revenue by 2015. Two casinos, one run by **Genting Singapore** and the other by **Las Vegas Sands**, have attracted about 3 million to 4 million visitors since they opened earlier this year, according to Jonathan Galaviz, a gambling industry consultant. The casinos, located in lavish hotel and shopping complexes, may add almost a full point of growth to 2010 gross domestic product, says Song Seng-Wun, an economist at CIMB Research in Singapore.

Finally, there is Singapore's drive to become a financial center serving clients in India, China, and the Middle East. Its bank secrecy laws remain intact, unlike Switzerland's, and the supply of potential customers is rising rapidly as newly minted millionaires proliferate through the region. Singapore's assets under management grew 40 percent last year, to $871 billion.

Faster growth may prod the Monetary Authority of Singapore to do more at its next policy review in October, according to Kit Wei Zheng, an economist at Citigroup in Singapore. Wage pressures are increasing, and inflation may reach 5 percent by the end of 2010, up from 3.2 percent in May. The central bank manages the Singapore dollar instead of interest rates to contain inflation. It has already signaled that it wants the currency to appreciate, which it has–slightly–against the U.S. dollar.

The bigger risk is how Singapore handles a global slowdown in the second half. Casinos can empty out pretty fast if people feel poor. Whatever happens, growth feels better than the opposite: Singapore's economy contracted last year. —*Shamim Adam*

The bottom line *Singapore's economy is outpacing China this year, thanks to thriving pharmaceutical and financial-services sectors and new casinos.*

Regional Economics

In Japan, the Provinces Are Withering Away

▶ **Tokyo keeps growing while rural areas lose people and jobs**

▶ **"This used to be a lively place. We're hoping life returns"**

On the block where Mika Nasu's clothing shop sits along the main street of Atami, a resort town 65 miles south of Tokyo, 13 of 19 stores are shuttered. "Recovery? What recovery?" asks Nasu, 50. "It just gets worse and worse."

Nasu's struggles are reflected in the Bank of Japan's *Sakura Report*, a regional survey akin to the Federal Reserve's *Beige Book*. In the July 8 report, companies from seven of Japan's nine regions expect business to worsen in the next three months. Kanto, the region that includes metropolitan Tokyo, is the only one where business anticipates any improvement.

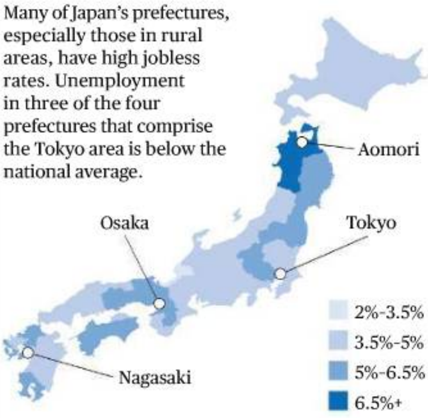
If the economy consisted solely of

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Global Economics

Japan's Rural-Urban Divide

Many of Japan's prefectures, especially those in rural areas, have high jobless rates. Unemployment in three of the four prefectures that comprise the Tokyo area is below the national average.



DATA: JAPANESE INTERNAL AFFAIRS MINISTRY

urban areas like Tokyo, Osaka, and Nagoya, things would look better. Tokyo's unemployment rate is a few notches below the national average of 5.2 percent and well below the 8 percent recorded in the north. While the young flee rural Japan, Tokyo's population has grown by 1 million in the last decade. The economy of Tokyo and its surrounding areas generates 31 percent of GDP. Factory jobs are disappearing throughout Japan as the country's multinationals shift production abroad. Still, Japan's big companies are expected to stay based in Tokyo, where the service industry is strongest and the talent pool deepest. "The disparity is widening," says economist Tamai Chino, who studies regional economies at Mizuho Research Institute.

Chino worries about the impact of the drive to cut the national deficit. Local governments rely on funds generated by taxpayers in Tokyo, a reliance that discouraged independence in the regions, according to Martin Schulz, a senior research fellow in Tokyo at Fujitsu Research Institute. "They never saw the [need] to develop their own business models, their own products, their own bridge to global markets," he says. In the July 11 upper house elections, rural voters punished Prime Minister Naoto Kan for slashing public works. With the deficit so huge, though, the cutbacks are likely to continue. For places like Atami, revival will just be harder.
—Aki Ito and Toru Fujioka

The bottom line *The gap between Tokyo and rural Japan is growing ever wider. Budget cuts will accelerate rural decline.*

Jurisprudence

Freeing India's Courts From Their Red Tape

► **The government tries to fix a legal system that strangles companies**

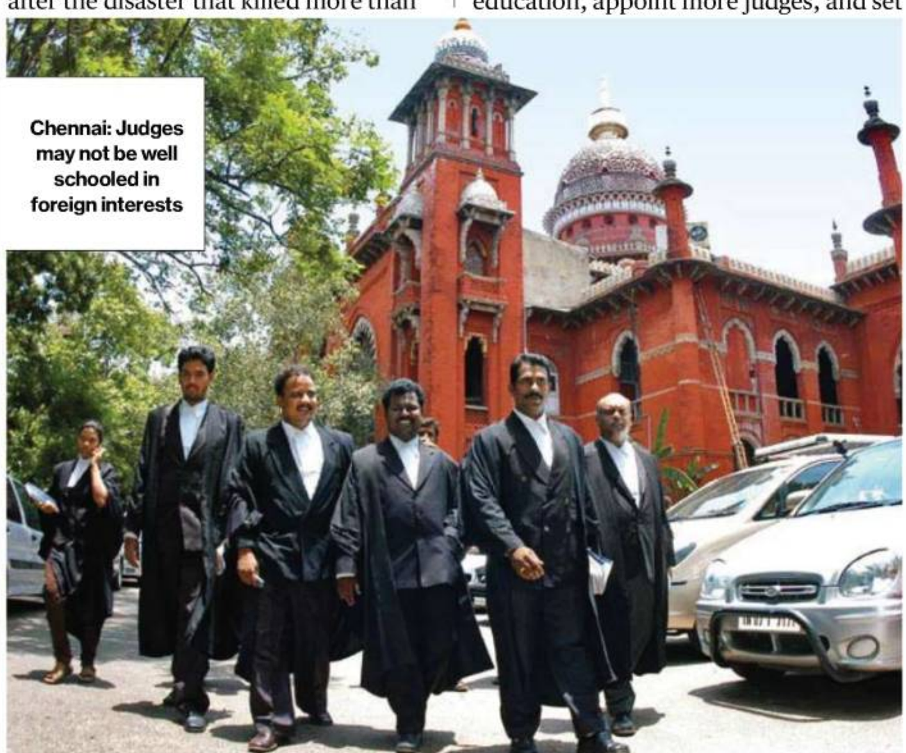
► **"It's well-known that litigation is a no-go zone"**

Which emerging Asian economic power has the more open legal system, China or India? China is a Communist Party dictatorship where laws are drafted in secret by party cadres and the courts were largely destroyed during the Cultural Revolution. India, by contrast, has a thriving democracy, a dynamic legislature, and a common-law system inherited from the British.

Indian courts, however, are anything but dynamic. "It's well-known that litigation in India is a no-go zone for companies because of how long it takes," says Gautam Battacharyya, a partner at Pittsburgh-based law firm Reed Smith who has his office in London and often works in India. The sentencing last month of seven former Union Carbide executives to jail terms for their role in the Bhopal gas leak—25 years after the disaster that killed more than 22,000 people—is an egregious example, though even lower-profile cases can easily drag on for more than a dozen years (the convicted Carbide executives can still appeal). Lawyers, regardless of which side they're on, are adept at seeking long adjournments. Judges, in short supply to begin with, often lack critical knowledge about topics such as infrastructure that bedevil foreign and local companies. The system is vulnerable to corruption, too: "Our judges are paid abysmal amounts," says Cyril Shroff, managing partner at Amarchand & Mangaldas, India's largest law firm. "Both the average businessman and corporations have little faith in the legal system."

Last month, Law & Justice Minister Veerappa Moily unveiled a package of reforms to slash the average duration of court cases to 3 years from 15. The Attorney General's office will scrutinize all suits brought by and against the government—some 70 percent of cases—to throw out the frivolous ones and keep only those with merit. Government attorneys and judges will have a better shot at promotions that would boost their salaries. The reforms will likely go into effect before the end of July.

Prime Minister Manmohan Singh's government also wants to improve legal education, appoint more judges, and set



Chennai: Judges may not be well schooled in foreign interests

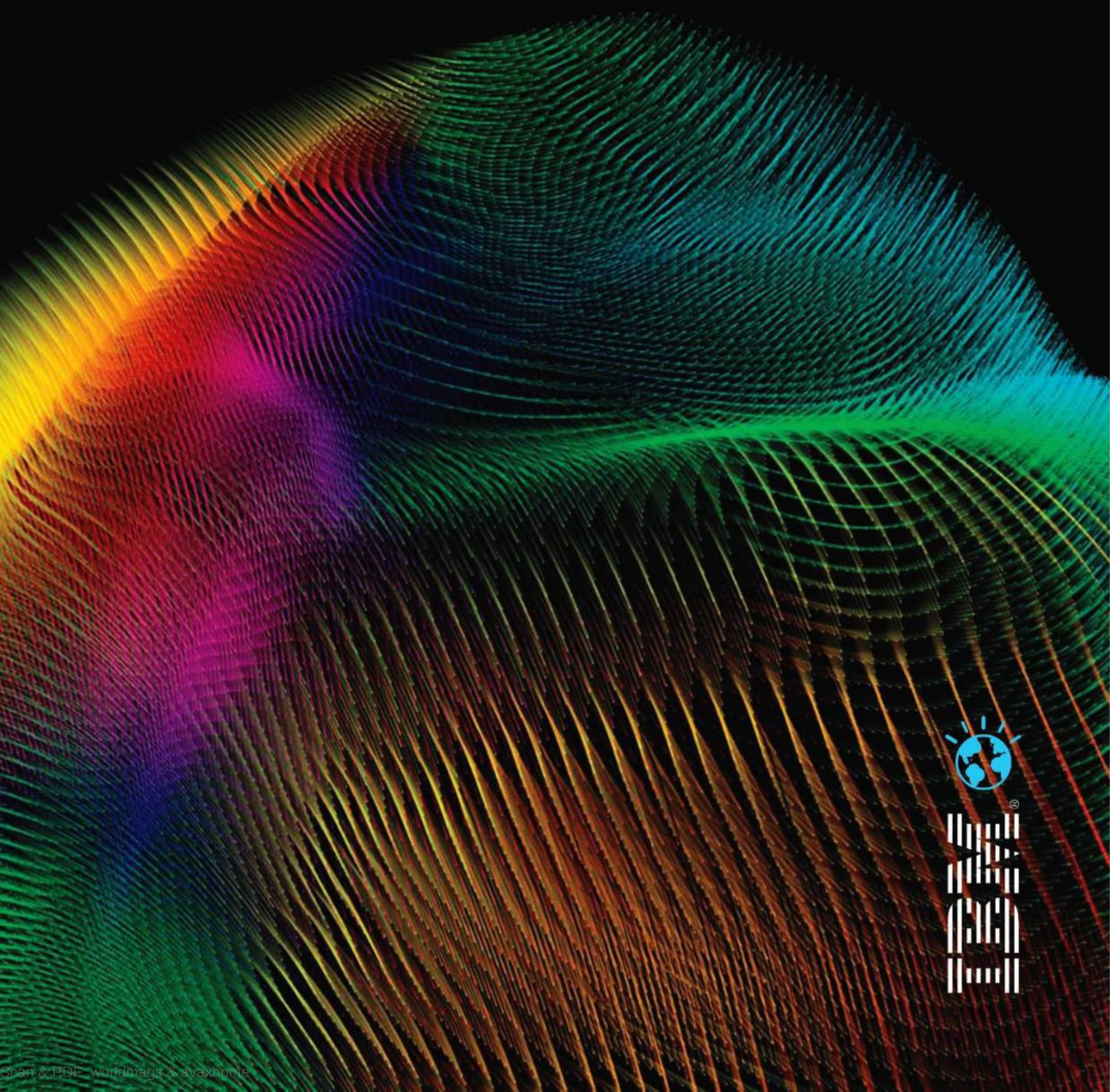
HK RAJASHEKAR/THE INDIA TODAY GROUP/GETTY IMAGES

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How fast does a system have to be to capture a business opportunity?

How do you cut costs without cutting results?

How do you benchmark intelligence?



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up specialized courts to handle complex cases. Pramod Rao, general counsel for ICICI Bank, the No. 2 lender, figures it will take two to three years for the changes to make a real difference.

Even if these reforms improve the courts' efficiency, the Indian legal system will remain more closed in some ways than China's, which has developed significantly in recent years. While U.S. and other foreign law firms are allowed to have multiple Chinese offices, India prohibits foreign lawyers from having permanent offices or advising clients on Indian law. In December the Bombay High Court reaffirmed a 1995 decision keeping non-Indian companies from opening local offices. To get a piece of the booming market, foreign law firms have set up alliances with Indian firms or flown in partners from Singapore and Hong Kong for short stints.

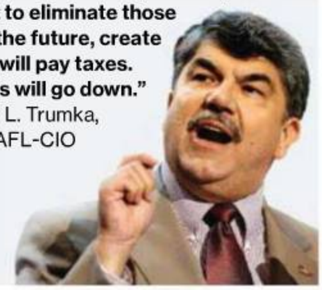
Some Indian attorneys want to restrict foreign law firms even more. A court in the southern city of Chennai is considering a suit brought by a local group of lawyers to ban 31 foreign firms, including White & Case and Clifford Chance. If the foreign defendants lose, "It could mean that top Indian companies doing deals overseas won't be able to get international advice in their own offices," says Jeffrey A. Blount, head of the Asia Pacific practice in Hong Kong for Houston-based Fulbright & Jaworski.

Until the scope of the reforms becomes clear, multinationals looking to invest in India are likely to avoid its legal system as much as possible by opting for third-party arbitration outside the country. Yet arbitration leads back to the same problems that keep companies away from the courts, says Rajesh Narain Gupta, managing partner of S.N. Gupta & Co., a Mumbai-based law firm. "Foreign investors are conscious of delays in Indian courts, so they prefer dispute resolution overseas," he says. "But even if they are awarded settlements abroad, they need to be enforced in India–and that process is again subjected to many delays." *—Ruth David and Kian Ganz*

The bottom line *India's Justice Ministry has launched reforms to speed up the resolution of cases; foreign attorneys will still face restrictions.*

Quoted

"In the short term the U.S. does not have a deficit crisis. We have a job crisis, and if you want to eliminate those deficits in the future, create jobs. They will pay taxes. The deficits will go down."
—Richard L. Trumka, President, AFL-CIO



Global Trade

Eastern Exposure

China's GDP, which grew 11.9 percent in the first quarter, is now growing more slowly. Imports are likely to ease as a result. That would have meant little to German, U.S., and other exporters 10 years ago. Today, China is a top consumer of commodities and products from around the world.

Exports to China by Region

North America
1999 $21.8bn
2009 $89.4bn
U.S. only: $69.6bn

South America
1999 $3.0 bn
2009 $64.0bn



European Union
1999 $74.3bn
2009 $128.0bn

Africa
1999 $2.4bn
2009 $43.2bn

Asia
1999 $101.7bn
2009 $602.7bn

Top U.S. Exports to China by Category (2009)

Soybeans	$9.92bn
Semiconductors	$5.33
Chemicals	$3.99
Plastic materials	$3.59
Steelmaking materials	$2.70
Pulp and paperboard	$2.50
Industrial machines	$2.35
Copper	$1.98
Electrical equipment	$1.88
Measurement equipment	$1.52
Aluminum and alumina	$1.50
Computer accessories	$1.44
Telecom equipment	$1.37
Industrial engines	$1.24
Medical equipment	$1.23



California wine exports to China
▲64%
from 2008 to 2009

Corporate Exposure to China

	Revenues from China	As % of total
Advanced Micro Devices (U.S.)	$2.45bn	42.5%
Nvidia (U.S.)	$2.59	39.2
Yum Brands (U.S.)	$3.68	33.9
Micron Technology (U.S.)	$1.24	25.9
BHP Billiton (U.K.)	$9.87	19.7
Valle (Brazil)	$5.24	17.3
Intel (U.S.)	$5.84	16.6
Boeing (U.S.)	$4.89	7.2
Siemens (Germany)	$3.22	6.8

DATA: BLOOMBERG, CHINA CUSTOMS ADMINISTRATION, BUREAU OF ECONOMIC ANALYSIS

EMILE WAMSTEKER/BLOOMBERG

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Smarter business for a Smarter Planet:

It's time to ask smarter questions.

What exactly does a benchmark mean? For the last five years, IBM DB2® on Power Systems™ has ranked first on three of the industry's leading performance benchmarks, longer than Oracle and Microsoft combined. But is that the best way to think about the possibilities of technology? What really matters isn't some abstract measure of performance, it's what companies actually do with that performance. For instance, Globe Telecom is using a service delivery platform from IBM to increase their sales by 112%. EuResist is using an integrated analytics solution to predict the most effective drug combinations for individuals with HIV, with 78% accuracy. And CAIXA Econômica Federal, one of the largest banks in Latin America, is using a service oriented architecture to slash infrastructure acquisition costs by over $330 million. On a smarter planet, these are the benchmarks that matter.

A smarter business is built on smarter software, systems and services.
Let's build a smarter planet. ibm.com/questions



1. Based on number of days of performance leadership for the TPC-C, TPC-H 10TB, and SAP 3-Tier SD benchmarks between June 1, 2005, and June 1, 2010. For more information, see http://www.tpc.org and http://www.sap.com/solutions/benchmark. TPC, TPC-C and TPC-H are trademarks of the TPC. IBM, the IBM logo, ibm.com, DB2, Power Systems, Smarter Planet and the planet icon are trademarks of International Business Machines Corp., registered in many jurisdictions worldwide. Other product and service names might be trademarks of IBM or other companies. A current list of IBM trademarks is available on the Web at www.ibm.com/legal/copytrade.shtml. © International Business Machines Corporation 2010.

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Global Economics

Can Hefner safeguard the bunny hutch? page 27 ▶



Emerging Markets

Pass the Test, Get a Loan, Start a Company

▶ Harvard researchers devise a way to spot Third World entrepreneurs

▶ "Millions of businesses simply aren't financed"

1. Do you like taking things apart to see how they work?
2. Do you enjoy going to parties?
3. Given five seconds, how long a sequence of numbers can you memorize?

If your answers to these and about 150 other questions add up, you could run a small business in Nairobi. Or Lima. Or Bogotá. All because a new test identifies the traits that make for successful entrepreneurs in developing economies.

The Entrepreneurial Finance Lab (EFL), a branch of the Harvard Kennedy School's Center for International Development, has devised a psychometric test to help banks in emerging markets easily screen loan applicants. The goal is to spur lending to small and midsize companies, a vital sector often underfunded in the developing world. These companies are too big to rely on microfinance, yet not big enough to be served efficiently by the banks. "There are millions of businesses in developing countries that could earn significant returns on additional capital that aren't financed," says Bailey Klinger, EFL's director. "And it's not that banks aren't interested in them. Quite the opposite. They just don't have the right tools."

The 40-minute computer-based test assesses traits like honesty, ethics, intelligence, and motivation. The EFL says three years of pilots in South Africa, Kenya, Rwanda, Colombia, and Peru have shown that the test achieves the same–or better–results than traditional ways of assessing a borrower's future success and ability to repay a loan. With the test, local banks can cut default rates by 25 percent to 40 percent, says D.J. DiDonna, EFL's director of business development. They will also be able to extend loans to clients whose credit histories are sparse or nonexistent.

In developed countries, psychometric tests are widely used by blue chip companies to evaluate possible hires. Klinger and his colleague Asim Khwaja came up with the idea of applying these tests to evaluate creditworthiness, in part because academic research showed that characteristics like IQ influence the rate of credit returns. The EFL consulted industrial psychologists, studied the literature on entrepreneurs, and extracted elements from existing tests. The resulting evaluation can be customized to reflect an applicant's business, company size, and country, though the core questions remain the same. The EFL says the tool can save banks time and money, since standard screening can take three days or more when banks don't have existing borrowing histories to draw on.

South Africa's **Standard Bank**, the continent's biggest, has signed on to become EFL's first paying client and roll out the test in South Africa and Kenya this August. "We're hoping a flagship client like Standard Bank, as they scale up quickly, will open the door for other banks," says DiDonna. "As you can imagine, banks are pretty risk-averse." If the test works in Africa, EFL hopes to introduce it to the U.S. and Canada, where many immigrant entrepreneurs also lack credit histories and collateral.

—Caroline Winter

The bottom line *Harvard researchers have devised a simple, inexpensive way to test the business skills of would-be entrepreneurs in emerging markets.*

42.3

BILLION DOLLARS

The U.S. trade deficit for the month of May. Economists had expected $39 billion. Instead the trade deficit expanded 4.8 percent over April's data. U.S. imports and exports both rose to their highest level since 2008.

DATA: COMMERCE DEPT.

Tom Keene's EconoChat

Tom talks with Harvard University history professor **Niall Ferguson** about European stress tests, Germany, and British austerity

These stress tests in Europe, what's the historical precedent of trying to get transparency? Can they work?
Well, of course, they worked–or at least seemed to work–in the U.S. There's a completely different culture in European banking, and it's the opposite of mark to market. The culture in German banks for decades, even centuries, has been to lend long to some industrial concern, and you don't really look too closely at how that thing does over the years.

During my recent trip to London, many people there were talking about Germany. Whither Germany, given the financial crisis?
There are two big issues about Germany. One is obviously whether the Germans are really getting it about the role that they have to play in moving Europe out of this near-depression. The Germans just want to run surpluses–and if everybody tries to run a surplus, we end up in a depression. The other part of the story is frankly the hypocrisy of the Germans on the subject of the Greek crisis. The reality is that it was the German and French banks that got bailed out because they were the principal holders of all that dodgy Greek debt.

How will the economics of austerity play in Britain?
The public sector unions are going to go completely ape when the cuts are announced. There's going to be job cuts, pension cuts, pay cuts across the board. B



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

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Contents ▶ Coke's World Cup song goes mega 24 ▶ The race to spot Alzheimer's earlier 25 ▶ George Steinbrenner, 1930-2010 26 ▶ Hunting the Playboy bunny 27 ▶ Asia's low-cost carriers spread their wings 27 ▶ Business briefs: Beemer floors it 28 ● Edited by James E. Ellis

Big Oil Turns Its Back on BP

▶ In hopes of protecting drilling, rivals distance themselves

▶ "We shouldn't lump the entire industry together"

In an industry in which companies rarely criticize each other publicly, the Gulf disaster has touched off some unusual infighting. And beleaguered **BP** is the punching bag. Ever since the oil rig explosion in the Gulf, which has cost BP $3.5 billion and counting, rivals have been distancing themselves from the British oil giant. The latest flap: Two of BP's business partners in the stricken well, **Anadarko Petroleum**, based in The Woodlands, Tex., and MOEX Offshore, a unit of Japanese energy concern **Mitsui Oil Exploration**, have refused to help pay for cleanup costs. BP has asked Anadarko, which has a 25 percent stake in the well, to pay $272 million. Mitsui, a 10 percent owner in the well, has been asked to contribute $111 million.

On June 18, Anadarko Chief Executive Officer James T. Hackett caused a stir in a statement in which he said: "The mounting evidence demonstrates that this tragedy was preventable and the direct result of BP's reckless decisions and actions." Mitsui hasn't commented. BP thinks both Anadarko and Mitsui should pay their share. Both companies approved of "certain key decisions relating to the well," a BP spokesman said on July 13.

Another source of tension involves the future direction of offshore drilling regulations. The BP spill has fouled not only the waters and beaches of the Gulf but also one of the energy companies' most lucrative and fast-growing sources of oil and gas. After the Apr. 20 accident that triggered the spill and killed 11 people, the U.S. government halted drilling in water deeper than 500 feet, creating a huge hurdle for energy companies.

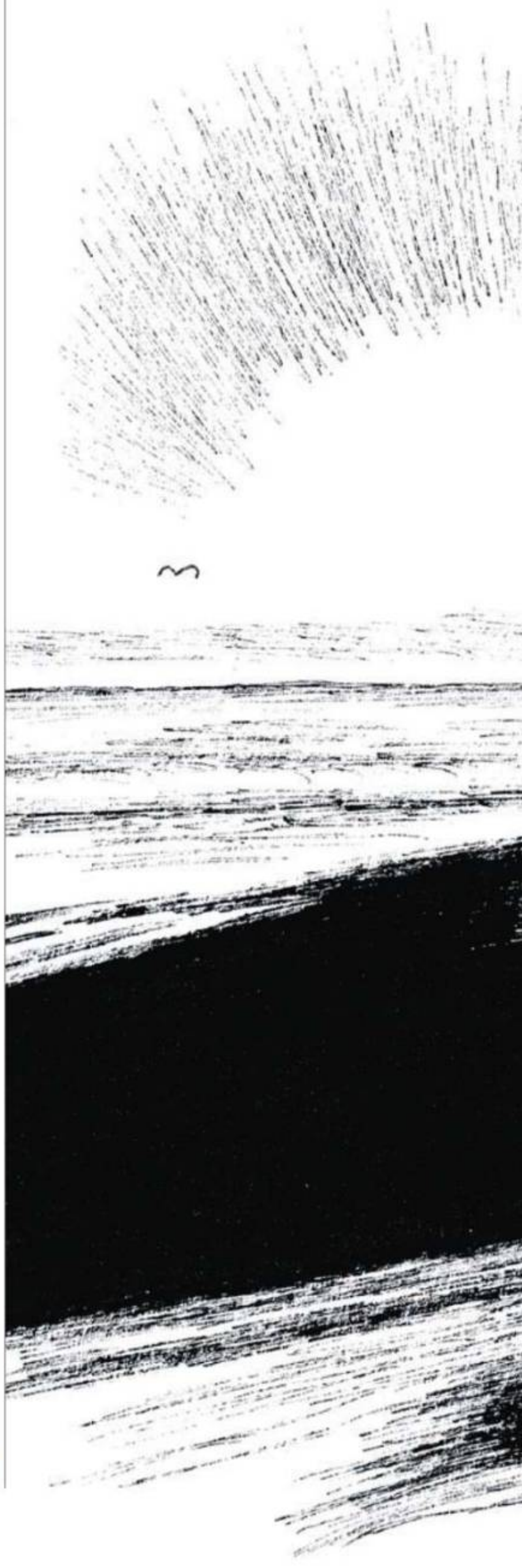
The disaster has touched off unusual infighting in an industry where rivals seldom criticize each other

As a result, **ExxonMobil** and **Royal Dutch Shell** are now trying to persuade politicians and regulators that their practices are different from BP's—and that companies that operate safely should be allowed to keep drilling. ExxonMobil CEO Rex W. Tillerson said during congressional hearings on June 15: "When you properly design wells ... and focus on safe operations and risk management, tragic incidents like the one in the Gulf of Mexico today should not occur."

Back in May, in a letter to the Minerals Management Service, which regulates drilling, **Shell Oil** U.S. President Marvin E. Odum listed a series of the company's drilling practices that differ from what has been reported about BP's well. Odum contended that around the world Shell uses safer well designs than the one that blew out on BP and incorporates extensive redundancy into its safety features, which should reduce the chances of a similar accident.

The American Energy Alliance, a Washington-based lobbying group financed by the energy industry, has launched a website called Save U.S. Energy Jobs, which offers interactive graphics illustrating the gaps between BP and other oil company industry practices. The AEA also calls the drilling moratorium "The Second Gulf Disaster" because of its impact on jobs and U.S. energy security. "We shouldn't lump the entire industry together," says the group's president, Thomas J. Pyle.

More than a dozen oil services companies made a similar argument before a federal appeals court on July 9. The companies claim the blanket suspension fails to distinguish between companies that adhere to modern safety practices and BP. "The industry leader is ➔



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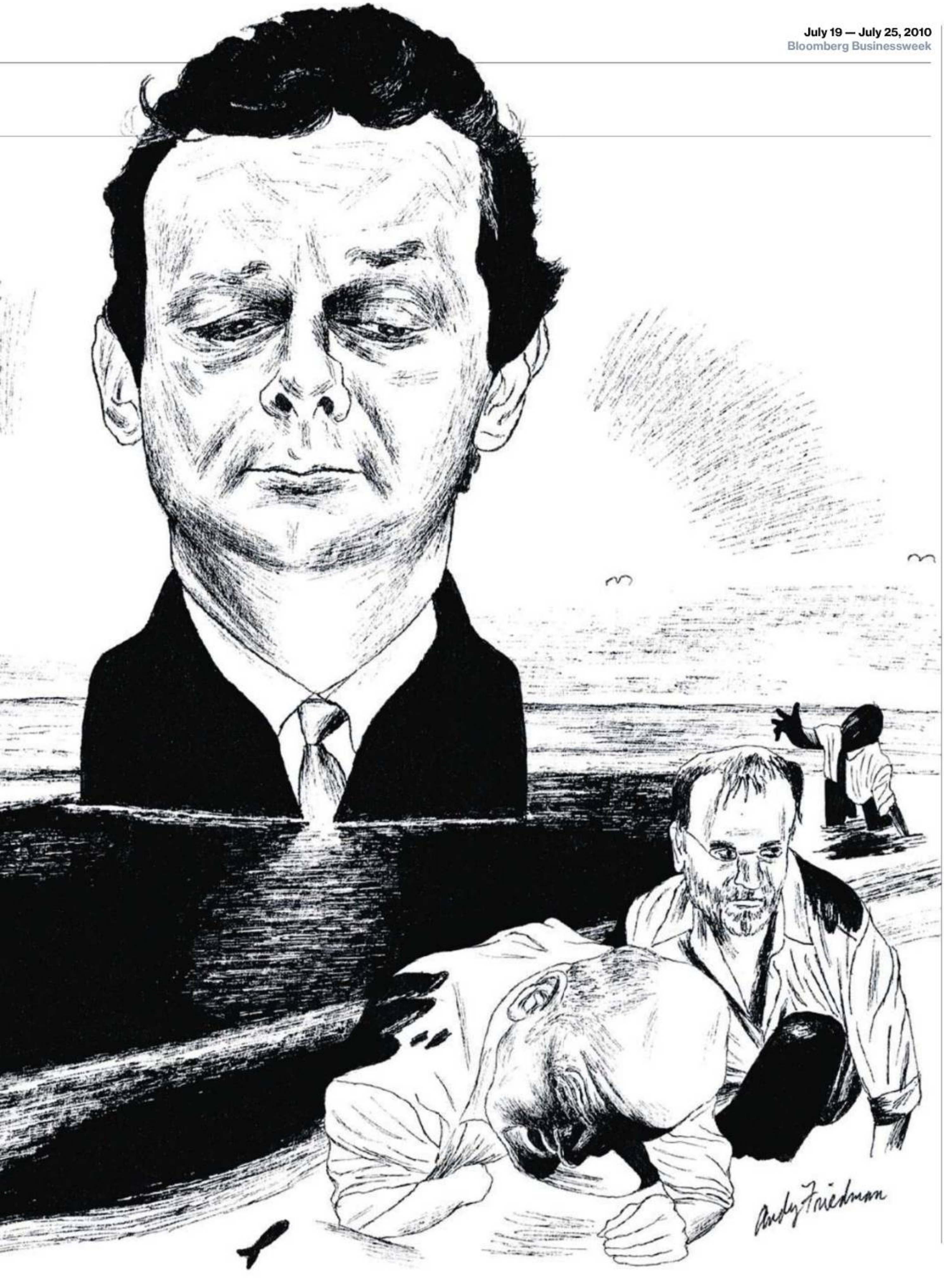


ILLUSTRATION BY ANDY FRIEDMAN

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Bush's tax breaks could live into 2011 page 36 ▶



being treated the same way as the industry laggard," says John Cooney, an attorney for **Hornbeck Offshore Services**.

The American public seems to be buying the industry line. Three-quarters of those surveyed in a Bloomberg National Poll published July 15 say that the spill was "a freak accident" that shouldn't shut down deepwater drilling. "People say BP must pay, but there's no sense of impending doom," says J. Ann Selzer, president of pollster Selzer & Co.

Outraged as they may be with BP, rivals so far have done little to unwind the business partnerships that bind the industry. Because drilling and developing oil and gas fields costs billions, each project tends to be taken on by consortia rather than single companies. ExxonMobil, for instance, remains BP's partner in Thunder Horse, the largest producing platform in the Gulf of Mexico. Even Anadarko is committed to working with BP in Brazil, when BP completes the acquisition from **Devon Energy** of Brazilian properties in which Anadarko is a partner. Whatever the differences, it's still mostly business as usual. —*Stanley Reed, with Kim Chipman*

The bottom line *Eager to resume drilling in the Gulf, oil companies are distancing themselves from BP and painting its safety practices as substandard.*

Marketing

Coke's World Cup Song Hits the High Notes

▶ **The beverage giant's song became a global music and marketing hit**

▶ **"Word of mouth is a great thing in the music industry"**

Music industry executives have been making an unusual pilgrimage to **Coca-Cola**'s Atlanta headquarters, a telling measure of the company's successful World Cup soccer marketing blitz. They want to learn how Coke turned a song called *Wavin' Flag* by a little-known Somali-Canadian hip-hop artist into a World Cup anthem and No. 1 iTunes hit in 17 countries in less than a year. "They are getting on planes from New York, from U.K., from Los Angeles," says Joe Belliotti, Coke's director of global entertainment. "Word of mouth is a great thing in the music industry."

Initially, Coke had hoped only to create a World Cup song good enough to entice stadiums full of soccer fans to sing along. To get there, it forged an unusual partnership with singer-songwriter K'naan and his label, A&M/Octone Records, that has ended up changing the way Coke works with entertainment companies.

The song was the musical centerpiece of Coca-Cola's largest marketing campaign ever, reaching 160 countries. A smaller effort four years ago at the World Cup in Germany helped boost volume sales of drinks in Coke's largest markets an average of 6 percent, says Emmanuel Seuge, who runs worldwide sports and entertainment marketing. Coke's goal was even higher-volume sales gains during the 2010 World Cup campaign, he says. Coke also expects gains in consumer perception scores.

Being able to tie the campaign to a song that easily crossed borders was critical. Coke had hoped the use of a single global marketing theme (it used 13 different ad campaigns in 2006) would save $45 million in costs. Seuge said Coca-Cola may have nearly doubled those savings, in large part because of the effectiveness of *Wavin' Flag* across cultures.

The song is a rewrite of a recording from K'naan's February 2009 album *Troubadour*, which sold only 89,000 copies, according to Nielsen SoundScan. Soon after the release, Coca-Cola sent an open brief to the music industry—much like it sends to ad agencies soliciting ideas for television campaigns—spelling out what it wanted in a song.

The music had to capture the spirit of host-continent Africa and the celebratory mood in soccer stadiums. It also had to tie in Coke's year-round global marketing campaign, Open Happiness, right down to the inclusion of the recognizable five-note melody used in its ads. And Coke wanted the artist to have an uplifting backstory.

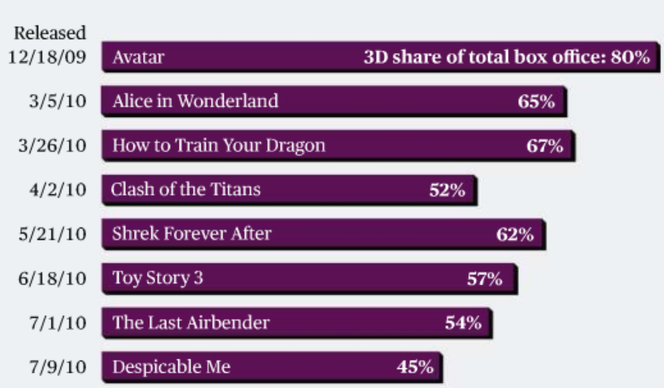
Belliotti, who then worked for a company called Brand Asset Group, brought K'naan to Coca-Cola. Brand Asset was founded by Violator Management Chief Executive Officer Chris Lighty, who represents the likes of 50 Cent and Mariah Carey.

Coke's marketers liked the singer and his multinational upbringing as well as *Wavin' Flag*'s sweeping melody and hopeful chorus: "When I get older, I will be stronger. They'll call me freedom, just like a waving' flag." Darker verses detailing K'naan's struggle as a child in Somalia and his "fighting to eat" wouldn't work. So K'naan (full name

Entertainment

3D Mania Shows Signs of Fatigue

Since the release of *Avatar*, consumer interest in three-dimensional films has fallen vs. their 2D versions. One reason: Consumers resist the $3.50 ticket premium for 3D, except for highly anticipated blockbusters. —*Michael White*



DATA: BOX OFFICE MOJO, THE INTERNATIONAL 3D SOCIETY, BLOOMBERG RESEARCH

LEFT TO RIGHT: ERIC DRAPER/THE WHITE HOUSE/REDUX; MICHELLY RALL/GETTY IMAGES

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will.i.am and K'naan at a World Cup Kick-off concert in Johannesburg

Keinan Abdi Warsame) offered to write a version of *Wavin' Flag* with lyrics more befitting a soccer tournament.

K'naan and his producers added a bridge with Coke's five-note melody and pumped up the African vibe with chanting and drums. The lyrics now talked of champions taking the field and fans rejoicing in "the beautiful game." K'naan also recorded versions of the song with pop stars ranging from the Black Eyed Peas' will.i.am to Japan's AI and Spain's David Bisbal, broadening its appeal.

Although financial details are confidential, Coca-Cola co-owns the rights to its Celebration Mix of *Wavin' Flag* along with K'naan and his record company, owned by **Vivendi**'s Universal Music Group. Coke, which split the cost to tour K'naan around the world, is plowing the unexpected profits from the sale of *Wavin' Flag* downloads into its six-year, $30 million Replenish Africa Initiative, which seeks to provide clean water and better sanitation. The continent figures big in Coke's long-term growth plans, where water scarcity is an immediate problem as well as a long-term threat to the company's beverage production.

The real coup for Coke, says Seuge, is discovering a new way to tie its brand to things young consumers care about—soccer and pop music—without seeming heavy-handed. He says Coke may now expand the concept to video games and other creative works, and may even take stakes in entertainment companies themselves. —*Duane D. Stanford*

The bottom line *Coke commissioned a song for its World Cup marketing campaign, tying its brand to two obsessions of global youth: soccer and pop music.*

Pharmaceuticals

Getting an Earlier Warning of Alzheimer's

▶ Three companies are vying to bring diagnostic tests to market

▶ "It's hard to come from behind unless you're superior"

General Electric, **Bayer**, and **Avid Radiopharmaceuticals** are racing to give doctors a tool they've sought for 100 years: an early test for Alzheimer's. A quick, definitive diagnosis would enable patients to start drug treatments earlier, participate in clinical trials for experimental medicines, and plan for their futures. If a test came back negative, the doctor would be able to look for other causes of memory lapses, such as small strokes.

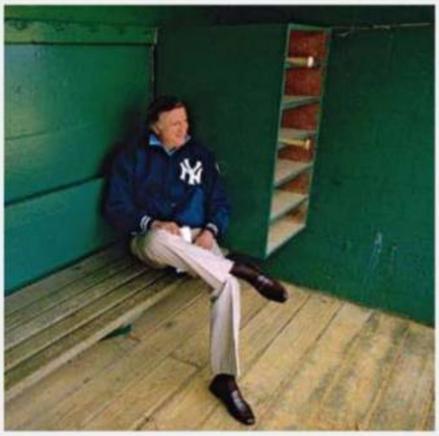
The companies are developing dyes to identify clumps of brain proteins called beta amyloid that are markers for Alzheimer's. Avid, a Philadelphia start-up, completed the final stage of testing needed for U.S. approval and aims to submit an application to the Food & Drug Administration before yearend. That may give it a year's head start before products arrive from GE and Bayer. The three companies presented their data at the International Conference on Alzheimer's in Honolulu that ran from July 10-15. As many as 5.1 million Americans may suffer from the disease, according to the National Institutes of Health. Worldwide, the market for the new diagnostic dyes could be worth $3 billion a year, estimates Cambridge (Mass.)-based consultants Scientia Advisors.

The dyes are designed to cause beta amyloid concentrations to light up when patients' brains are scanned using PET, or positron emission tomography. Currently the tell-tale proteins can be seen only in an autopsy. To spot the disease closer to its onset, doctors must rely on memory tests, family history, and interviews with relatives. While there is no cure, drugs such as Aricept, from **Pfizer** and **Eisai**, can ease the symptoms and may be especially helpful if administered at an early stage. Once the new imaging agents are available, the Alzheimer's market could swell to $10 billion, according to Scientia.

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Obituary

George Steinbrenner



1930-2010

The owner of America's richest sporting franchise wouldn't settle for losing, or for squeeze-bunt wins

George Steinbrenner, the imperial owner of the New York Yankees who died on July 13 at 80, riveted the sports world with his free-spending ways and back-office shenanigans. And for all his excesses, the man sportswriters dubbed "King George" left the arena a champion. It's not simply because the Yankees clinched seven World Series victories during his turbulent reign. Steinbrenner restored the Bronx Bombers to their former glory, turning them into the richest team in baseball and a global brand. His triumphs often irked fellow owners, who resented his throwing around money as if there were no tomorrow.

Then again, that's the way Steinbrenner rolled. "We'd be winning games, and he'd be semi-embarrassed because we'd win on a squeeze bunt or a base hit," recalled former Yankee manager Joe Torre, who departed in 2007. "He wanted to mutilate people."

Steinbrenner credited his insatiable drive to his father, Henry, a shipping magnate. "He graduated from MIT near the top of his class and became the school's only NCAA champion in track and field ever," Steinbrenner once said. "I was an only son, and I knew he was always watching."

Steinbrenner went to Williams College, where he studied English literature and ran track like his dad. He joined his family's Kinsman Marine Transit business in 1957 and went on to become fabulously wealthy. He never lost his passion for sports. He hit the big time in 1973 when he and his partners bought the Yankees from CBS for $10 million. He later bought out the others.

Under King George, the Yankees won two early championships, followed by a 13-year playoff drought during which his feuds overshadowed the team's performance. He hired and fired manager Billy Martin five times. In 1990 Steinbrenner paid an admitted gambler $40,000 for damaging information about outfielder Dave Winfield. Commissioner Fay Vincent banned Steinbrenner from baseball for life, then reinstated him for the 1993 season.

Shortly thereafter, the franchise regained its footing and won four World Series in a five-year span through 2000. By 2005 the Yankees were the most expensive sports team ever assembled in North America, with a payroll of $208 million. That brought it its seventh Series in 2009. Earlier this year, *Forbes* estimated the Yankees' value at $1.6 billion.

After the 2007 season, Steinbrenner named family members to top posts at the holding company for his team and its regional television network. His health deteriorated, and he was rarely seen in public. But he didn't let up. "I keep telling my guys, 'Always remember that winning is everything,'" Steinbrenner said in a 2005 interview. "It's a way of life." —*Laurence Arnold*

Born ▶ **Rocky River, Ohio, heir to a Great Lakes shipping business**

Motivation ▶ **The long shadow of a successful father drove him to excel**

Legacy ▶ **A sports and broadcasting empire worth an estimated $1.6 billion**

Companies&Industries

Avid's early lead doesn't guarantee success. Marketing prowess also counts, as does the accuracy of the brain scans produced with the aid of the dyes. "When you're running a marathon, it's hard to come from behind unless you're superior," says Scientia managing partner Harry Glorikian.

Jonathan Allis, global head of imaging for GE Healthcare, contends that only his company has the combination of hardware, software, and "wetware" (for non-science geeks, that's biology) to prevail. "Amyloid imaging alone is not enough," he says. Diagnosis and treatment should also involve behavioral assessments and monitoring for abnormal proteins in the blood. Then there's "the need for powerful software analysis to help clinicians make sense of it all," says Allis.

German drugmaker Bayer has no presence in the medical equipment market. But it has had a stake in diagnostics since the 1930s, and imaging agents are a natural outgrowth of that business, says Barbara Putz, Bayer's head of clinical development for molecular imaging.

To make up for its small size, Avid may opt to take on a partner to help sell its Alzheimer's test. One candidate could be **Siemens**. In addition to making the dye for Avid, the German company sells a range of medical imaging equipment, including PET scanners. Avid Chief Executive Officer Daniel M. Skovronsky declined to comment on the future of the relationship with Siemens other than to say that startups like Avid have a need for strong partners and backers. "We are always thinking about where our next dollar is going to come from," says Skovronsky.

One of the tests' biggest contributions may be to spur development of new treatments for Alzheimer's. P. Murali Doraiswamy, who heads the biological psychiatry division of Duke University's Institute for Brain Sciences and has been involved in Avid's drug trials, believes the dyes will give researchers a real window into the disease. Says Murali: "You can pick out patients who have higher levels of amyloid, expose them to treatments, and see if the treatment is clearing out the amyloid in the brain or not." —*Elizabeth Lopatto and Kanoko Matsuyama*

The bottom line *The race is on to create a diagnostic test for Alzheimer's disease. The prize is profits and better patient care.*

LEFT TO RIGHT: WALTER IOOSS JR./SPORTS ILLUSTRATED/GETTY IMAGES; BURT GLINN/MAGNUM PHOTOS; MICK TSIKAS/REUTERS

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Vintage Hefner: At the former Playboy mansion in Chicago, 1966

Media

Hefner Wants His Bunnies Back

▶ Playboy's founder makes a bid for the media empire he built

▶ "Our interest is mostly the digital assets," a rival says

Few media brands have been as storied or durable as Playboy, which went from defining the sexually curious male of the 1950s, to chronicling the good life of the 1970s, to being another casualty of the Internet Age. So when founder Hugh Hefner on July 12 made public an offer to pay $123 million for the shares of ailing **Playboy Enterprises** that he does not already own, a more than 30 percent premium, he and his private equity backers at Rizvi Traverse Management likely thought they would receive a hero's welcome.

Hardly. Hefner and Playboy management have been hit with a shareholder suit claiming that any sale to the founder–just as new management is trying to revive Playboy's fortunes–wouldn't maximize shareholder value. To complicate matters, **FriendFinder Networks**, which owns rival men's magazine *Penthouse* as well as adult websites, quickly announced it is preparing a competing bid for Playboy.

FriendFinder Chief Executive Officer Marc Bell, whose company scrapped its initial public offering earlier this year, says it's interested in online content from Playboy, which publishes its namesake men's magazine, creates videos for its website and cable-television networks, and licenses products with its bunny-ear logo.

Playboy said the 84-year-old Hefner, who owns 69.5 percent of Playboy's Class A voting stock and 27.6 percent of the Class B nonvoting shares, isn't interested in a merger or sale to a third party. Hefner wants full control of the Playboy brand and the magazine's editorial direction.

Playboy's impact on American culture is far larger than its price tag. After Hefner founded the company in 1953, *Playboy* magazine won a following for its satirical cartoons, fiction, and photos of nude women. The first issue of the magazine included photos of Marilyn Monroe, and authors such as Vladimir Nabokov were published in *Playboy*'s pages.

The company expanded around the globe throughout the 1960s and 1970s with Hefner at the helm. It added membership clubs, resorts, and casinos. Playboy went public in 1971; the magazine's circulation peaked in 1972 at 7.2 million. Revenue has fallen for the past two years, and the company has lost more than $200 million. This year the company reduced *Playboy* magazine's rate base, the newsstand and subscription sales guaranteed to advertisers, to 1.5 million from 2.6 million.

In 2009, the company hired Scott Flanders as CEO to focus more on brand management. Flanders replaced the founder's daughter, Christie Hefner, who had served as CEO for 20 years as her father continued to live in the Playboy mansion and personify the swinger lifestyle. The Los Angeles area villa, which the company uses for television shows and photo shoots, is "an enormous asset to us," says spokeswoman Martha Lindeman. "It's a huge part of our brand."

Hefner still squires voluptuous young women around the mansion while clad in his trademark silk smoking jacket. Some of the octogenarian's most recent girlfriends star with him in the TV show *The Girls Next Door* and related online videos. Bell says that if he successfully purchases Playboy, he won't oust Hefner from the mansion. "Our interest is mostly the digital assets," he says. "We have no desire to throw him out." —*Brett Pulley*

The bottom line *The men's magazine mogul makes a bid to regain his empire and focus its brand after years of decline.*

Airlines

In Asia, Discounters Go For the Long Haul



▶ New low-cost airlines, with ties to majors, tackle international routes

▶ The flights are "transforming the whole aviation landscape in Asia"

The expansion of discount carriers like **Southwest Airlines** and Europe's **Ryanair** has redefined air travel. Yet one area where the low-fare model hasn't clicked is in long-haul international flying. From Sir Freddie Laker's pioneering Skytrain of the 1970s to London-based Zoom Airlines, which folded in 2008, carriers that offered long-distance service on the

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cheap have failed. Despite that sobering record, both **Qantas Airways** and **AirAsia** are challenging long-haul companies like **Singapore Airlines** with a low-fare model.

There's a key difference in these latest discount assaults: support from large, existing airlines. Qantas' Jetstar Airways unit, which already offers cheap flights within Australia, will add budget long-haul flights from Singapore later this year. Jetstar intends to begin Singapore-Melbourne flights in December, followed by services to Auckland in March. Later it plans to add flights to other European and Asian destinations.

AirAsia X, 16 percent-owned by AirAsia, the continent's largest budget carrier, already flies from its Kuala Lumpur hub to London and Australia and plans new service to Japan and South Korea. Its partnership with AirAsia lets it tap connecting traffic to about 70 cities from Kuala Lumpur. And Jetstar shares some flights with Qantas and has a partnership with **Air France-KLM Group**, Europe's largest carrier. Such deals may help the upstarts avoid the fate of stand-alones like Zoom and Oasis Hong Kong Airlines, which also folded in 2008.

"Long-haul, low cost is transforming the whole aviation landscape in Asia," says K. Ajith, an analyst at UOB Kay Hian Research in Singapore. "If [budget airlines] have a strong network and are viable, they can potentially lure passengers from established carriers."

AirAsia X charges from about 1,286 ringgit ($402) for a flight from Kuala Lumpur to Stansted Airport, 40 miles outside of central London. An economy ticket from Kuala Lumpur to Heathrow Airport on **Malaysia Airlines**, the nation's largest carrier, starts at about 2,104 ringgit ($657).

AirAsia X cuts costs by using fewer flight attendants, since it only loads and serves hot meals that customers have preordered. That saves the carrier up to $100 per passenger, says Chief Executive Officer Azran Osman Rani. Jetstar formed a venture with AirAsia in January, lowering costs for spare parts and ground-handling services. ❸ —*Chan Sue Ling*

The bottom line *New Asian discount airlines hope links to large existing carriers will help them succeed in long-haul markets that have long defied upstarts.*

In brief

By Cristina Lindblad



BMW's 5 Series sedans helped boost sales in the year's first half

BMW

Beemer Maker Sees Smooth Road Ahead

The German maker of luxury cars has raised its sales forecast for 2010 based on a better-than-anticipated first half. BMW now expects to sell more than 1.4 million cars and SUVs this year, a 10 percent increase over 2009 and 100,000 more than its previous forecast. BMW, along with its Mini and Rolls-Royce divisions, boosted sales by 13 percent in the first half of the year, to nearly 700,000 units, buoyed by deliveries of the 5 Series, 7 Series, and X1 model.



Intel

Good Tidings from the Tech Bellwether

The world's biggest chipmaker reported record second-quarter sales and topped analysts' estimates with its forecast for the current quarter, allaying concerns that a rebound in technology spending is losing steam. Intel said third-quarter sales will be $11.6 billion, plus or minus $400 million. The chipmaker also boosted its gross margin—the percentage of sales remaining after deducting production costs—to 67 percent from 51 percent a year ago. Chief Executive Officer Paul Otellini expects the PC market to rise as much as 16 percent annually through 2014, helping maintain Intel's sales gains.



Burberry

The Purveyor of Plaid Beats Estimates

Burberry topped analyst estimates when it reported a 27 percent gain in first-quarter sales, to $436 million. The British luxury goods retailer was buoyed by rising sales in Asia and increased deliveries to wholesale customers, who are restocking as consumers spend more on high-end apparel and accessories. Burberry plans to add 20 to 30 stores in the Americas and Asia-Pacific this year.

China Life

An Insurer Braces for Competition

China Life and other major Chinese insurance companies tumbled in Shanghai trading on July 12 after regulators announced plans to scrap a decades-old price cap on the guaranteed rates of return for certain life insurance contracts. China Life Insurance, the nation's biggest insurer, fell 6.7 percent, and China Pacific Insurance declined 6.6 percent. Analysts say the new regulations will likely intensify price competition and squeeze profit margins.

GlaxoSmithKline

Winding Down the Avandia Controversy

GlaxoSmithKline has agreed to pay about $460 million to resolve a majority of lawsuits alleging the company's Avandia diabetes drug can cause heart attacks and strokes. The settlements, which work out to an average of at least $46,000 apiece, come as the company braces for its first Avandia trial in federal court in Philadelphia in October. On July 14, a majority of the members on a U.S. panel of experts found that data show that Avandia carries a greater risk of heart ailments than other diabetes drugs but stopped short of recommending that the Food & Drug Administration pull it from the market.

Itaú Unibanco

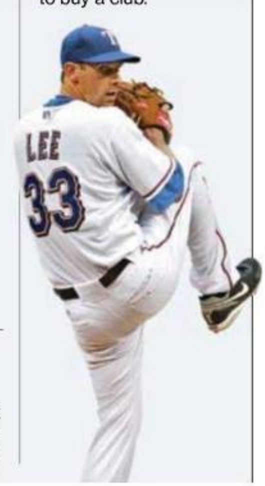
A Homegrown Giant Beats Back Invaders

Itaú Unibanco overtook Citigroup and Goldman Sachs in Brazilian bond underwriting in the first half of 2010, leading a push by local banks to grab market share from international banks hurt by the global financial crisis. Itaú, Brazil's largest bank by market value, also jumped four spots to become the No. 4 manager of overseas bond sales by the Brazilian government and companies, the highest ranking for a local underwriter in more than a decade. Itaú and others are capitalizing on a twofold rise in overseas issuance this year, to $17.2 billion.

Texas Rangers

The Bankrupt Baseball Club Is Up for Bid

The future of the Texas Rangers, the baseball club that filed for bankruptcy in May, will be decided at an Aug. 4 auction. Current owner Tom Hicks had sought permission from a bankruptcy judge in Fort Worth to sell the club to a group led by Hall of Fame pitcher Nolan Ryan and attorney Chuck Greenberg in a transaction valued at $575 million. William Snyder, whom the court appointed to oversee the bankruptcy, wanted to solicit competing bids. On July 13 the judge set the August date for an auction to be opened by the Ryan bid. Snyder says that doesn't leave other bidders much time to pass a background check and win approval from Major League Baseball, which are requirements to buy a club.



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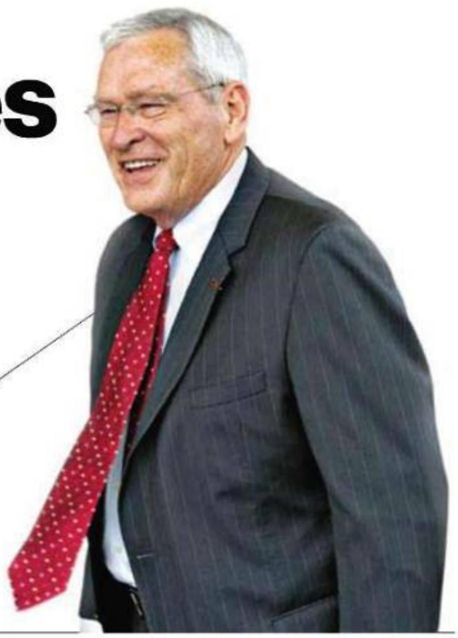
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Politics&Policy

GM's IPO May Require Hefty Incentives



Ed Whitacre
Chairman of GM

▶ **The sales pitch will need hope, contrition, and smooth talking**

▶ **"GM and Treasury will pay a price" for spurning bondholders**

The initial public offering of recently bankrupt and nationalized **General Motors** looks to be one of the trickiest deals in memory.

True, the still-enormous carmaker has shed billions in liabilities and legacy costs in its "quick-rinse" 39-day bankruptcy. After a federal rescue, GM is again profitable, and its vehicles are selling briskly in the U.S. and China. Yes, the Treasury Dept., which extended close to $50 billion of aid to the behemoth last year, is a motivated seller, eager to prove the bailout a success in an election year in which many voters say bailouts wasted their money. "The initial public offering will be a significant step in carrying out Treasury's previously announced intention of disposing of TARP investments as soon as practicable," states a Treasury memo on the deal, not yet scheduled but widely expected before the November elections.

The Wall Street underwriters, likely to be **Morgan Stanley** and **JPMorgan Chase**, are so keen to participate that they are accepting a 75 percent discount on their fees, says one person briefed on the matter. Various estimates peg the flotation, including about 20 percent of the government's 61 percent stake, at $12 billion, which would make it the second-largest in a decade, after **Visa**'s $19.7 billion deal in 2008. And do not underestimate GM Chief Executive Ed Whitacre's resolve. "The new management team desperately wants to feel like a legitimate company again," says Steve Dyer of Craig-Hallum Capital Group, a Minneapolis-based trading and research shop. "That can only happen if they get rid of the perception that they're still reliant on the government."

GM must persuade investors burned by the government takeover to buy its shares again

All great, save for one thing: It's not clear that investors are pining to buy GM 2.0. This could be an IPO unlike any other, and not only because Uncle Sam is hawking the shares. The main selling point will not be a quick return on investment. Instead, it will be that GM's limited record of success—the company just reported its first quarterly profit since 2007—is only the beginning. Throw in contrition and appeals to hope and patriotism, and GM just might have a successful offering.

Job No. 1 is restoring "Government Motors" to a staple investment for institutional shareholders. That means convincing investors it can consistently make a profit in a leaner car-selling market. There's no getting around the reality, though, that GM has a ways to go before it wins over the car-buying public. In an April *Consumer Reports* study of reliability among 15 automakers, GM scored second to last. GM has shed the Hummer, Pontiac, Saab, and Saturn brands and now consists of Buick, Cadillac, Chevrolet, and GMC.

Then there's the let-bygones-be-bygones part of the IPO sales pitch: GM must persuade investors burned by the government takeover and unconventional bankruptcy to buy its shares again. That might require mediation by the U.N. after a bankruptcy proceeding in which the United Auto Workers union received more of the newly issued stock than some bondholders—a rearranging of the stakeholder pecking order that would not have happened in a traditional court-managed filing. "GM and Treasury will pay a price for that," says Maryann Keller, a veteran auto industry analyst who advises large investors. "Three words," says William Smith of New York-based Smith Asset Management, a former holder of GM's old shares: "Smoke and mirrors." He calls the preference given to the UAW in the bankruptcy "dirty pool," something "unprecedented in a democratic country with bankruptcy rules."

Even after its restructuring, GM has a troubling pension burden. Its retirement plan is underfunded by $26.8 billion. While the company doesn't have to make a payment for three years, at some point more money will have to go into the plan.

There are other questions: The reception for GM's much anticipated all-electric Volt, which the

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Selling a "street-legal plane" page 43 ▶



company says it will roll out at the end of next year, is uncertain. So is GM's plan to fix its European operations, which lost $506 million in the first quarter. Another unknown is what kind of auto market GM needs to stay in the black. The sales levels of 16 million to 17 million cars a year that once prevailed? Or the present 11 million?

Keller argues that demand has been reset downward because of lagging personal income, fading consumer confidence, and the end of easy credit. Detroit, she notes, has spent the past four decades extending the typical car loan from two years to five or six, to reduce monthly payments and get more units out the door. Now, she says, "we're really at the limit of what you can do with creative auto financing." GM's lack of a dedicated finance arm could also be a problem. "GM will launch an IPO when the conditions are right and the company is ready," says spokeswoman Nina Price, declining further comment.

Perhaps the strongest case for a resurrected GM stock is that many fund managers will have no choice. What was too big to fail a year ago remains too big to ignore in current investing terms. **Ford**, which is the only other remnant of the Big Three available to investors, is the 53rd-largest component in the Standard & Poor's 500-stock index, according to Bloomberg data. GM, which is now probably worth more than Ford's $40 billion valuation, would almost certainly be restored to the S&P 500, the preferred benchmark for mutual funds. "Most fund managers need and want exposure to the space," says Craig-Hallum's Dyer.

The underwriters have a tricky assignment: Unless the stock market ultimately values the 102-year-old automaker at a truly impressive $80 billion, taxpayers will not break even. With confidence flagging in the overall economic rebound and the auto industry's wobbliness in recent months, "the risk remains high that an IPO in this environment is unlikely to generate the best returns for the taxpayers," writes Bill Visnic, a senior editor at Edmunds' AutoObserver.com. As any good dealer will admit, you need heavy incentives and smooth talking to move a rebuilt car off the lot. *—Roben Farzad, David Welch, and Jeff Green*

***The bottom line** Despite a shaky economy, the White House is eager to refloat General Motors after its government takeover and bankruptcy.*

Midterm Elections

A Poll Shows Obama and The Democrats at Risk

▶ Republicans stand to benefit from a higher "intensity factor"

▶ "We don't want to have our grandkids paying for this"

Barack Obama has his work cut out for him as the midterm elections draw near. Americans disapprove of how the President has handled virtually every issue he has confronted and are deeply pessimistic about the nation's direction, a Bloomberg National Poll shows.

The President's overall approval is at 52 percent, roughly what it has been since December 2009. Yet majorities or pluralities disapprove of his handling of the economy, health care, the budget deficit, the Afghanistan war, the overhaul of financial regulations, and **BP**'s leaking oil well in the Gulf of Mexico. Obama's rating is higher than President Bill Clinton's 42 percent in July 1994 and lower than President George W. Bush's 73 percent in July 2002, according to Gallup data.

Almost two-thirds say they feel the nation is headed in the wrong direction, an even more sour assessment than in March, when 58 percent felt that way. Similarly, two-thirds of independent voters are pessimistic, while just 56 percent of Democrats offer a vote of confidence. After a year of economic growth, 71 percent say the economy is still in recession. "They have been hammered by the economy, and there is a disconnect between the lives Americans are living and Washington," says J. Ann Selzer, president of Selzer & Co., a Des Moines firm that conducted the nationwide survey. "They seem to have lost hope."

For Democrats, the survey may portend significant losses in November, when voters will determine which party controls the House and Senate. Given the anti-Washington mood, Republicans have the upper hand. Among independent voters often crucial to winning elections, GOP congressional candidates are preferred to Democrats, 44 percent to 32 percent. Among likely voters who view the election as exceptionally important–and provide the advantage that political consultants call the "intensity factor"–Republicans beat Democrats 56 percent to 34 percent.

A quarter of Americans, including 30 percent of Republicans and 21 percent of Democrats, say the nation would have been better off had Hillary Clinton been elected President.

Unemployment is easily the top issue, with 41 percent saying it is the most important matter facing the nation. "It downgrades our people if they don't have anything to do," says

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Gloomy Outlook

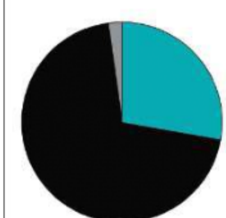
Americans see little improvement in the economy and are conflicted about how to balance concerns over joblessness and the federal budget deficit, the latest Bloomberg National Poll shows.

Would you say you are better off or worse off today than 18 months ago, or about the same?



Better off	**17%**
Worse off	**29%**
About the same	**54%**

The U.S. currently has a huge budget deficit and a high unemployment rate. Which should take priority?



Reducing the budget deficit	**28%**
Reducing the unemployment rate	**70%**
Not sure	**2%**

The poll of 1,004 U.S. adults was conducted July 9-12 by Selzer & Co. The margin of error is plus or minus 3.1 percentage points.

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63

PERCENT
of Bloomberg National Poll respondents who say the nation is on the wrong track.

DATA: SELZER & CO.

respondent Jane Phillips, an 80-year-old retired schoolteacher from Springfield, Ohio. After unemployment, the most critical issues were the federal deficit and government spending, followed by the oil spill in the Gulf of Mexico. The gap between Republicans and Democrats is stark when it comes to the budget. Among Republicans, 44 percent rank it as the most important issue, compared with 7 percent of Democrats.

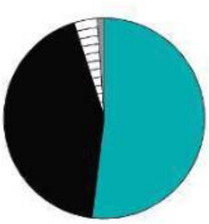
Among likely voters who say they are extremely interested in the election, a plurality of 41 percent say the deficit is the No. 1 issue. "The deficit is of paramount concern, because we don't want to have our grandkids paying for this," says poll participant Jeff Lockman, 41, a professional golfer and Republican from Malvern, Pa. "It's more like spend now and burn people later."

Obama's worst ratings come on his handling of the budget gap, where 59 percent disapprove and 37 percent approve. It's his worst grade on that subject in four Bloomberg polls since September 2009. The Administration expects the deficit this year to exceed $1.5 trillion.

While 45 percent say they have become more supportive in recent months of tougher regulations for Wall Street, the momentum is heading in the opposite direction from the White House on many other issues. Americans have grown less supportive of Obama's offshore drilling ban and more supportive of allowing local law enforcement to detain anyone who cannot produce proof of citizenship, as is contemplated in Arizona. *—John McCormick and Catherine Dodge*

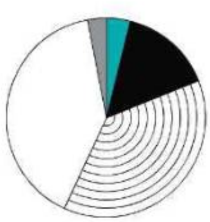
The bottom line *Four months before midterm elections, the mood of voters is bleak as they fault President Obama for his handling of most issues.*

Which of the following best describes your attitude toward the federal budget deficit?



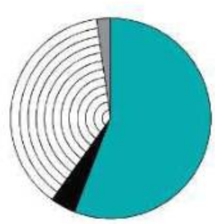
Dangerously out of control and threatens our economic future	52%
A manageable burden that will require sacrifice down the road	43%
Will cause no lasting harm	4%
Not sure	1%

How confident are you that new financial regulations will make your savings and financial assets more secure?



Very confident	4%
Fairly confident	15%
Just somewhat confident	38%
Not confident	40%
Not sure	3%

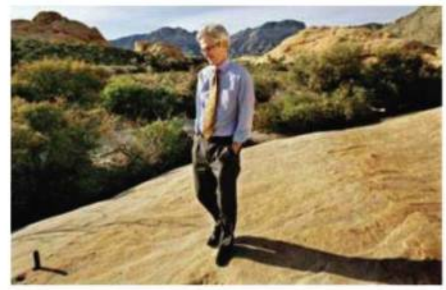
In paying for the oil spill, which of the following do you think is the best option?



BP must pay for it all, even if it goes bankrupt	56%
BP shouldn't be forced to pay beyond what it can afford, with taxpayers picking up the rest	4%
There should be a cap on what is paid out	38%
Not sure	2%

State Politics

What's in a Name? Rory Reid Will Find Out



▶ **Running for Nevada's top office, he steers clear of his Senator dad**

▶ **"He will be a great governor, but he has to run his own campaign"**

Rory Reid, the 48-year-old son of Senate Majority Leader Harry Reid, is running for governor of Nevada. You can just call him Rory.

The younger Reid knows the family name won't help him much this election year, even in his home state. Polls show that his father, 70, is struggling in his bid for a fifth term, with disapproval ratings hovering around 50 percent. The elder Reid is battling voter discontent over the economy and the government's heavy spending to fix it. Nevada's unemployment rate is higher than the nation's (14 percent vs. 9.5 percent), and its home foreclosure rate, at 1.26 percent in May, is about five times the U.S. average. Revenue for the gambling industry fell 10.4 percent last year, the biggest single-year decline in state history and a blow to tourism, the state's largest industry.

No wonder Rory, currently chairman of the Clark County Commission, is keeping his distance from dad. The Reids have attended few events together, and the first statewide television ad for Rory made no mention of his last name. Bumper stickers and campaign banners simply say, "Rory 2010." The biography on his campaign website makes no mention of his father. When Energy Secretary Steven Chu and Interior Secretary Ken Salazar joined Harry Reid earlier this month to announce a solar project that will create 1,000 new jobs for the state, Rory was conspicuously absent. A few hours later, President Barack Obama held

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Charlie Rose talks to

Valerie Jarrett



A top Obama adviser responds to criticism from business leaders and defends the President's record on the economy

How would you characterize the relationship between the Obama Administration and business?
Very strong and constructive.

As you know from comments by business leaders, they don't necessarily see it that way.
You can't let a comment here or there distort the reality. And the reality is we have extensive conversations with the business community. But you have to keep in mind that our objective is to protect the American people and provide rules of the road that will avoid the kind of economic meltdown we had 18 months ago or the dreadful oil spill we're in the midst of trying to clean up. And at the same time, we also have the objective of creating and fostering the kind of environment where companies want to invest and hire people. And mostly those two objectives align. But let's face it, some in the business community are not supportive of the regulatory reform we're hoping Congress passes any day now. But we are convinced that those reforms are going to provide the security the American people need to ensure we don't have another meltdown.

As you know, I'm including the entirety of American business—certainly not just Wall Street—and they do talk about the slow pace of trade and about this notion of demonizing business.
Listen, let's talk about the President's announcement to move forward with our new Export Council chaired by Jim McNerney [of Boeing] and Ursula Burns [of Xerox], two companies that are leading in terms of successful export policies. And we intend to move forward with all the free-trade agreements the President mentioned in the State of the Union: South Korea, Colombia, and Panama.

Tom Donohue of the Chamber of Commerce released a statement today saying the Administration and Congress took their eye off the ball once the economy started to stabilize.
I completely disagree.

After Verizon CEO Ivan Seidenberg, chairman of the Business Roundtable, made some critical comments about business and the Administration, you felt the necessity to write to him, as I understand it, to say we have an open door.
Well, let me go back a bit. At a meeting with Ivan, we agreed to work together in three areas: exports and trade, a revenue-neutral corporate tax policy, and regulations the business community thinks are burdensome that don't accomplish a public policy objective of ours. Ivan agreed he would send us a letter confirming what we agreed to work on, and I simply responded to his letter stating that I agreed with him and looked forward to working with him.

You have people who worry that the government today is reaching into virtually every sector of economic life and injecting uncertainty because it's unclear what the exit strategy is. And, with respect, it's more than simply regulation. It's the necessity of government to own large percentages of some crucial American industries—General Motors, Citibank.
If the President had not acted boldly ... our banking system would have collapsed. If he had not stepped in boldly and helped the automotive companies that were in deep trouble, we would have lost millions of jobs. Those were prudent, although unpopular, investments that we believe helped stabilize the economy. But President Obama is not interested in owning a large share of banks or automotive industries or anything in the private sector. There's nothing he would like better than for the private sector to be able to stand securely on its own two feet.

Are certain members of the business community trying to use the current economic circumstances to pressure the President into easing up on regulation?
I'll let the business community speak for itself. All I know is that we work hard every day to create an environment for companies to grow. I think we are putting in the fundamental pillars that will help support a self-sustaining private sector. Now we think we're beginning to see a trajectory in the right direction. We're seeing growth. We saw record earnings announced by Intel. We're moving in the right direction, and it is important that communication between the private and public sectors remains transparent and strong. The business community is one important stakeholder, but it's not the only stakeholder. B



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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a rally and fund-raiser for the majority leader. Where was Rory? Greeting supporters 450 miles away in the Washoe Valley.

Harry Reid is doing his part to help convince voters that his son–who trails Republican Brian Sandoval by more than 20 points–is running for the governor's office without his help. "He is my son, I care a great deal about him," he said after a rare joint appearance at the state Democratic convention last month. "He will be a great governor, but he has to run his own campaign." Dan Hart, a Nevada-based Democratic consultant, says the name game isn't about politics. "It's more of a search to define himself than a repudiation of his dad," he says.

That's not to say the younger Reid hasn't benefited from his father's strong alliances with the casino industry. Rory enjoys the exclusive support of **MGM Resorts International**, the state's largest casino operator: Its political action committee gave him $45,000. He had nearly five times as much cash as his opponent at the end of May. Republicans scoff that the money won't be enough to make Rory's rebranding successful. "When Harry says Rory's on his own, do you really think people of average intelligence are going for that?" asks Mark Amodei, the state's Republican Party chairman. —*Lisa Lerer*

The bottom line *Harry Reid's son is distancing himself from his unpopular father, yet he remains far behind in the Nevada gubernatorial race.*

Local Government

The Latest Fiscal Buzz? Medical Marijuana



▶ **Cities are taxing dispensaries to trim budget deficits**

▶ **"We should step up to the plate and pay our fair share"**

Here's a sure sign that marijuana dispensaries are on their way to becoming big business: On July 13 the city council of Berkeley, Calif., asked voters to approve a 2.5 percent tax on the city's marijuana outlets, three of which grossed a total of $19 million last year, all cash. "This is huge," says Mayor Tom Bates. The tax will not only help close a $16.2 million budget gap, but it also makes sure that as the sale of pot goes mass market, the local community benefits, not outside business interests, Bates says. "We don't want to have Philip Morris coming in here, sucking up all the money."



Taxing pot sales is a growing trend across the nation as fiscally challenged cities eye the public's budding acceptance of marijuana use. Denver has generated $1.2 million since December, when the city began collecting sales taxes from its 256 dispensaries. On June 15, Washington, D.C., approved a 6 percent tax on what will eventually be five dispensaries.

Eighteen states now have laws allowing marijuana use for medical purposes. Nowhere is the revenue opportunity as large as in California. Therapeutic marijuana was originally intended to relieve cancer and AIDS patients' pain and nausea; California now allows it for insomnia, appetite loss, or any condition a licensed physician thinks marijuana would ease. The Board of Equalization, which supervises tax collection in the state, estimated in October that fully legalized marijuana consumption could generate $1.4 billion a year in state and local taxes. On the same night that Berkeley officials acted, the Sacramento City Council passed a similar measure, and the city of Long Beach adopted one on July 6.

More Golden State communities may follow if California voters approve a ballot initiative in November that would make it legal to possess an ounce or less of marijuana for recreational use. That measure, known as Proposition 19, allows cities to regulate and tax recreational uses of pot. Recent polls suggest voters are evenly divided in their support for it, although Senator Dianne Feinstein (D-Calif.) on July 12 said she would oppose the measure. If the initiative passes, marijuana advocates and researchers describe a scenario in which drug tourism floods the state, resulting in tasting rooms and specialized bed and breakfasts in the Northern California counties of Mendocino and Humboldt, where the plant is cultivated.

Marijuana advocates are conflicted. They want to see more respectability for the drug and at the same time don't want to pay more for it. "We're struggling with this," says Kris Hermes, legal campaign director at Americans for Safe Access, an Oakland (Calif.)-based nonprofit. "We know local governments are cash-strapped and looking for creative ways to raise revenue." Others see taxation as a sign of progress. "Citi-

Drawing Board



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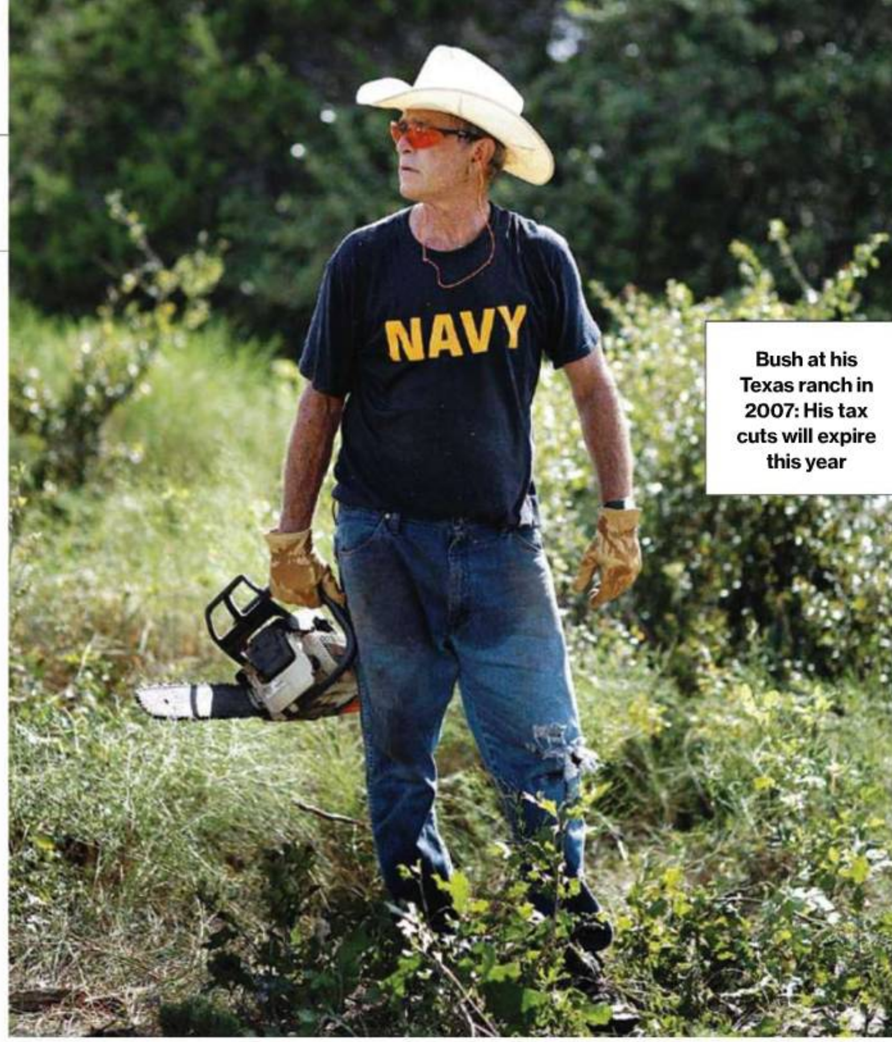
zens pay taxes, criminals don't," says Steve DeAngelo, the executive director of the Harborside HealthCenter, a marijuana dispensary in Oakland that campaigned for and won a marijuana tax in that city last year. "We should step up to the plate and pay our fair share." —*Christopher Palmeri and Michael B. Marois*

The bottom line *Cash-strapped cities increasingly are turning to marijuana dispensaries to raise tax revenue and close budget gaps.*

Tax Policy

Brinkmanship Over The Bush Tax Cuts

- High-income households could emerge as big winners
- "Anybody [in the Senate] who wants to obstruct right now is in paradise"



Bush at his Texas ranch in 2007: His tax cuts will expire this year

Until recently, it was a given that President Barack Obama would make good on his campaign pledge to let the Bush-era tax cuts that benefited wealthy Americans expire at the end of this year. Ditto for his promise to maintain the tax cuts for households earning up to $250,000 a year.

This being an election year and the economic recovery looking shaky, Washington is having a rethink. While lawmakers from both parties want to keep the tax reductions for families earning less than $250,000, Republicans say this is no time to raise taxes and insist on continuing the cuts for high-income families, too. Now a game of political chicken is unfolding, and wealthy Americans could benefit.

All the tax cuts (passed under President George W. Bush in 2001 and 2003) will expire on Dec. 31 if Congress fails to act, an outcome neither party desires. The middle-class reductions gave couples a 10 percent rate on their first $14,000 in income, subsidies for college expenses, a higher child credit, and relief from the marriage penalty.

In theory, it should be easy for Democrats to extend just the middle-income cuts. Budget rules adopted by Congress earlier this year allow lawmakers to extend them without offsetting revenue increases. That's a huge break: Keeping the cuts for the 130 million households earning less than $250,000 will cost about $255 billion a year.

There is no similar budgetary escape hatch that would let Republicans extend the tax cuts for the wealthy. They must find $55 billion in revenue to make up for the cost of keeping top marginal rates at 35 percent and dividends and capital gains taxes at 15 percent, among other reductions.

Democrats will need at least one Republican to get the 60 votes required to overcome procedural roadblocks in the Senate. Even then a single Democrat could hold up any deal. "Anybody who wants to obstruct right now is in paradise," says Senator Ron Wyden (D-Ore.). Republicans are loath to let taxes on high-income households rise, arguing economic growth should trump deficit concerns. They may even hold the middle-class tax cuts hostage until they get their way. Ohio Republican Senator George Voinovich says he opposes keeping any of the Bush tax cuts without offsetting revenues.

Reluctant to break Obama's campaign promises, Democrats may blink and allow a one-year extension of the entire package. "The simplest solution this year would be to say 'we have a struggling economy; we don't want to raise taxes at all,'" says Roberton Williams, a senior fellow at the Tax Policy Center, a Washington research group run by the Urban Institute and Brookings Institution. Wyden says a short-term extension would be a hard sell to Democrats who "don't want to ratify another round of Bush tax cuts" they had opposed. The brinkmanship is also worrisome for Republicans, who would pay a heavy price if their tactics failed—and everyone's taxes went up. B
—*Ryan J. Donmoyer*

The bottom line *High-income Americans could be the beneficiaries of a looming fight over whether to extend or let expire the Bush-era tax cuts.*

Quoted

"The charge that Tea Party Americans judge people by the color of their skin is false, appalling."
—Sarah Palin, responding to an NAACP resolution denouncing "racist elements" in the Tea Party movement



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James Warren

How Wal-Mart Won Chicago



The company needs new territory. The city needs sales tax revenue and jobs. So what took everyone so long to do the logical thing?

In a retail desert on the South Side of Chicago, amid vacant lots and signs promoting "affordable bankruptcy," sits a highly contested 200-acre plot that's the future of Wal-Mart. The company famous for low prices and high growth is nearly tapped out in the sticks and suburbs. Today, just 47 of its 4,300 Wal-Mart and Sam's Club stores are in big cities, and most of those are in Dallas and Houston. Urban America is the company's last frontier.

Since 2006 a single Wal-Mart has been homesteading in Austin, a mostly African American Chicago community with an unemployment rate of 40 percent, its alderman says. Now the company wants to put two dozen more stores in the city, including a 145,000-square-foot Supercenter on that 200-acre plot. In an area ravaged by poverty and desperate for the 400 jobs the Supercenter would provide, you'd think this would have been a slam dunk. It was not.

After the first Chicago Wal-Mart opened, unions and community organizations successfully lobbied the city council to pass an ordinance requiring Wal-Mart and other big box retailers to pay at least $10 an hour, with benefits. The legislation infuriated Wal-Mart and its chief advocate, Mayor Richard M. Daley. In response, Daley, the country's longest-tenured big-city mayor, exercised his first and only veto, then watched labor spend $3 million to elect a cadre of pro-union aldermen to the city council.

The mayor looked outside the city limits and saw that unions hadn't tried to stop Wal-Mart from operating in the suburbs. "Why didn't the unions object in the 'burbs? Suburbs are flooded with those stores," the mayor says. As for the argument that small businesses in the city would be imperiled, "go to New York and see all the small stores which have closed up. It's not because of Wal-Mart. It's because people are not spending." Daley also says Wal-Mart's management "got caught up in a national thing" by being too sensitive to attacks from unions.

The open warfare between labor and Wal-Mart showed no signs of ending until the recession forced both sides to reconsider. Chicago's political leaders realized the city couldn't continue to lose sales tax dollars to big boxes in the suburbs while failing to embrace the jobs offered by the Wal-Marts of the world. Wal-Mart had to feed the growth monster to keep shareholders happy. So on May 3 an unprecedented informal negotiation between company executives and labor leaders was held near O'Hare International Airport, according to three people who attended. The executives joked that Sam Walton would be turning in his grave if he knew about it, though the meeting itself hardly bridged the trust gap between the sides; the unionists, according to attendees, were required to sign confidentiality agreements, which they did.

With the door to rapprochement open a crack, Wal-Mart executives met Daley at a U.S. Conference of Mayors gathering last month in Oklahoma City to tell him about a "transformational" strategy. To win over Chicago, the company would build stores of various sizes, double its community spending to $20 million over five years, and ensure union construction of stores in the Chicago metropolitan area.

Starting wages were the final sticking point. First Wal-Mart signaled it would pay $8.75, or 50¢ more than the new Illinois minimum wage. When warned on the eve of a critical June 24 council vote that Wal-Mart was going to lose the Supercenter, negotiators agreed to a minimum 40¢ hourly hike after an employee's first year of service. Wal-Mart won't confirm any such deal, but according to union leaders, aldermen, and the mayor, the 45-0 council vote in favor was premised on those points. "I'm nervous about the camel's nose inside the tent, says Joe Moore, an alderman and Wal-Mart critic. "It's not a vote that was taken without mixed feelings. But the compromise on wages changed my vote."

Ultimately, Wal-Mart cracked Chicago by presenting a smart package of incentives and highlighting the lack of retail in the poorest communities, notably the absence of Chicago's two unionized supermarket chains, Jewel and Dominick's. The company may have blinked on wages–but so did labor, accepting an hourly figure it would have scoffed at a year ago. Everybody wins.

Except, not really. While unions were reflexively arguing that big box retailers are exploitative, Wal-Mart didn't endure much suffering. The unemployed did. So did shoppers on a budget. On a Monday trek to Chicago's current Wal-Mart, the parking lot in front of the store was packed by 10:30 a.m. Van Gooden, 56, a community representative for a nonprofit group, happily showed off his purchase: a white, button-down polo shirt slashed to $3.29 from an initial $12. Asked about Wal-Mart's impact on the impoverished ward, he said: "It's all about jobs and price." B

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Contents ▶ The end of Africa's wireless gold rush? 40 ▶ Bringing broadband to Finland's boondocks 42 ▶ Another lawsuit over Facebook's spoils 42 ▶ Innovator: Carl Dietrich's plan to make a commercially viable flying car 43 ● Edited by James Aley

Technology

Google Stays in China. And Baidu Keeps on Winning

▶ The Chinese Internet giant has increased its share of the search business to 64 percent

▶ "For the foreseeable future, Baidu will still monopolize the market"



Baidu in Shanghai. Its stock is up 82 percent in 2010

QILAI SHEN/BLOOMBERG

In early July, as Google executives waited for the Chinese government to renew its license to operate in the country, Baidu was dispatching a recruiting team to Silicon Valley. On July 10, Baidu's vice-president of engineering, Wang Jing, met dozens of applicants interested in moving to China to work for the No. 1 search engine in the world's largest Internet market. "People recognize Baidu is not just a local company," says Wang, 46. He joined Baidu in April after nearly four years with Google. "They understand our ambitions."

Baidu, which next month celebrates the fifth anniversary of its Nasdaq initial public offering, has enjoyed an 82 percent rise in its stock price this year. That compares with a 21 percent drop for Google and a 19 percent fall for Chinese portal Sina.com. Investors are rewarding Baidu for its dominance in the Chinese search market, where the company has a 64 percent share, according to Analysys International, a research firm in Beijing. That's more than double the share of second-place Google. "Baidu is willing to do whatever the government wants, to play by the rules. That's to Baidu's benefit," says Jason Helfstein, an analyst at Oppenheimer in New York. "Google is trying to do things that they think are the right thing to do, even if it has negative business implications."

Baidu's lead may grow, thanks in part to the technological convolutions Google has gone through to stay in business in China. In order to comply with Chinese law without violating its own commitment not to censor search results, Google created a landing page that appears after users in China enter a search term. When users click on a link on the new page, they get redirected to a search engine located in Hong Kong. (Chinese censorship rules don't apply in the former British

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Technology

colony because of Beijing's "one country, two systems" policy.) The extra steps are an inconvenience to users that will drive more people to Baidu, analysts predict. And where users go, advertisers will follow.

Google's China search engine "doesn't operate like a normal website," says Wendy Huang, an analyst in Hong Kong with RBS. "As long as Baidu keeps its core search business, companies will go to Baidu naturally." Baidu, she says, doesn't "even need to try too hard."

Baidu Chief Executive Robin Li, a State University of New York at Buffalo graduate who worked for Infoseek in the late 1990s before starting Baidu in 2000, is focusing on building the company's lead with new technology and old-fashioned marketing. Earlier this year he sent sales executives to 100 Chinese cities to meet with potential advertisers among small and midsize businesses and answer their questions about keyword advertising. The marketing push "has been quite effective in improving the brand," says Wallace Cheung, an analyst in Hong Kong with Credit Suisse. He expects Baidu to earn $493 million this year, more than double its 2009 profit, on sales of $1.2 billion, 84 percent higher than last year. Li's salespeople are also busy promoting Baidu's new online sales system, called Phoenix Nest, which makes it easier for companies to buy keywords as well as related words that don't necessarily use the same Chinese characters.

Next, Li may push Baidu into new businesses. He has tried to make the company a force in social networking, with a service allowing users to get in touch with people who make similar online queries. Teaming up with U.S. private equity firm Providence Equity Partners, the company has started a venture called Qiyi, an online video site similar to Hulu. Another joint venture, an e-commerce partnership with Japanese retailer Rakuten, launched a test site in June. Baidu owns 49 percent of RakuBai, with the Japanese partner owning the rest.

Not all of Baidu's ventures have panned out. The company's first attempt to expand beyond China, a search site in Japan, has not made a significant contribution to sales. Although Baidu in January fended off a lawsuit brought by Western record companies alleging it facilitated searches for pirated MP3 downloads, legal fights haven't ended. In an Apr. 30 statement, Neil Turkewitz, executive vice-president of the Recording Industry Association of America, decried what he called "brazen and notorious theft" by Baidu, which denies any wrongdoing. The company has had embarrassing problems at home, too. In July a Chinese court ordered Baidu to apologize and pay $3,200 to a woman whose ex-boyfriend posted nude photos of her online.

Rivals aren't surrendering the market to Baidu. Hong Kong-listed Tencent operates popular online games and runs China's dominant instant-messaging service. Google, for all its woes, isn't out of the action, either: The Web giant is still the strongest site for conducting searches in English, which happens a lot in China, says Morgan Stanley analyst Richard Ji. Still, Baidu is well positioned to grow stronger. It has 220,000 advertisers, a fraction of the potential market of 40 million small and midsize businesses, according to spokesman Kaiser Kuo. "We have a lot of space ahead of us."

—Bruce Einhorn, with Mark Lee and Brian Womack

The bottom line *With Google struggling in China, Baidu is thriving thanks to new products and old-fashioned marketing.*

37

PERCENT

Share of women age 18 to 34 who have fallen asleep with a smartphone in their hands, according to a July survey by Oxygen Media



DPA/ZUMA PRESS

Telecom

Spotty Reception for Mobile in Africa

- Vodafone, Bharti, and others face slower growth on the continent
- "You have to mine the people who can't really afford the service"

International soccer fans weren't the only ones recently lured to Africa. Over the last few years the world's major mobile operators have arrived on the continent. In March, India's Bharti Airtel paid $9 billion to acquire Zain Africa's assets in 15 countries. The U.K.'s Vodafone has spent $3.4 billion on deals in Africa, and France Telecom expects to spend as much as $8.8 billion in Africa and the Middle East over the next five years.

The phone giants hope to win business in such countries as Nigeria, where only 50 percent of the population now own phones and growth rates for mobile service are among the highest in the world. The prospect of untapped riches–Africa has 300 million people who lack mobile access–is particularly appealing to multinational companies with home markets marked by slow growth or none at all.

These hoped-for gains in Africa will come slowly according to some analysts. "The next round of growth in Africa is not as profitable as the first stage," says Mike Dunning, a managing director at Fitch Ratings in London. "The difference is quite dramatic." The best customers, he says, already have mobile-phone accounts. "You hit a certain point where you've got all the juicy subscribers covered, and you have to mine the people who can't really afford the service."

To maintain high growth rates, mobile providers are expanding into poorer, more rural areas. That translates into slower profit growth. France Telecom, for instance, is moving into rural Niger, hoping to become

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Technology



A shop in Sierra Leone: Africa has 300 million people without mobile phones

ANN JOHANSSON/CORBIS

the No. 1 operator in a country where per-capita gross domestic product is less than $2 a day. Companies are also investing heavily in Nigeria, even though South Africa's MTN Group reported that its average revenue per user in Nigeria has fallen from $18 at the end of 2006 to $11 in March 2010. "All growth is at the bottom of the market," says Rosalind Craven, an analyst at Business Monitor International in London.

Another problem for the mobile companies is fierce competition. While the U.S. and most European countries have just four major providers, African countries often have many more, because governments can earn quick cash by selling licenses. Nigeria, Africa's most populous country, had 11 providers at the end of 2009. In Tanzania, which has seven operators, competition has caused tariffs to fall by 80 percent in the 18 months ending in May, according to Vodafone's South African unit, Vodacom.

The providers also face the difficulty of working with Africa's mercurial governments. In 2008, Vodafone bought a 70 percent stake in state-owned Ghana Telecommunications; last October a government-commissioned body recommended renegotiating the sale and raising the $900 million purchase price. Tanzania recently told Bharti it must renegotiate its acquisition of Zain's unit there. Countries from South Africa to Nigeria are pushing to slash interconnection rates, which are the government-regulated fees telecom operators collect for completing a call from a rival network.

African customers change their minds regularly, too. More than 95 percent of mobile subscribers there prepaid for their service last year, the highest proportion of any region in the world. With no penalty for switching operators, between 4 percent and 6 percent do so every month, costing the African mobile industry about $11.4 billion annually, according to consulting firm Green Giraffe.

Yet foreign companies remain determined to compete—perhaps because there's no real alternative. Revenue growth in Africa is still much higher than what Vodafone and Bharti see in their home markets. So the multinationals push ahead: Vodafone describes sub-Saharan Africa as one of its "priority areas" for expansion. Bharti says it plans to invest about $600 million in Nigeria over the next three years. Five years ago it took only six months for companies to recover investments in mobile infrastructure in Africa, says Marc Rennard, the head of France Telecom's African, Middle Eastern, and Asian operations. "Now it's more than two years. But that's still pretty good." —*Matthew Campbell and Nicky Smith*

The bottom line *Poverty, mercurial governments, and fierce competition make Africa tough terrain for mobile operators hungry for new markets.*

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Technology



Young renters revive Miami real estate page 44 ▶

Internet

Bringing Broadband to Finland's Boondocks

▶ The Finns guarantee high-speed Net access, even for remote towns

▶ "People on the periphery pay more to get what others get for free"

Nordic countries are proud of giving their citizens the good life. Finns, for example, have the legal right to social security, universal health care—and now, broadband access. A law that took effect on July 1 guarantees all Finns access to fast Internet service—1 megabit per second or better, speedy enough to download an MP3 in less than a minute—for "a reasonable price," suggested at no more than $50 a month. The law was the legacy of previous Prime Minister Matti Vanhanen, who stepped down last month, and sought to bridge the digital divide between wired cities like Helsinki and the less connected countryside. His program also provides $83 million to build high-speed networks of up to 100 Mbps in some of the country's most remote regions.

One such place is Utsjoki, Lapland, the European Union's northernmost community, where fishing and reindeer herding are common jobs. The Finnish government is paying more than half the $3.4 million cost to provide Utsjoki's 1,300 people—spread across an area larger than Rhode Island—with an underground fiber-optic trunk line. Citizens still have to pay for the cable that connects their homes to the trunk—a cost that can total thousands of dollars. "A good network is something you have to have these days," says Antti Katekeetta, a municipal manager in Utsjoki, who says the new system should be more reliable than either above-ground phone lines, which can blow down in storms, or the region's patchy wireless reception.

"Some households are in such remote areas that markets won't provide any fiber or fast connection," says Communications Minister Suvi Lindén, who estimates that absent government intervention, 4 percent of Finland's 5.3 million people could go without decent broadband access. The government, now run by Prime Minister Mari Kiviniemi, hopes the speedy connections won't just eliminate the digital divide but will lower the cost of providing some essential services by, for example, enabling online health monitoring or virtual doctor visits.

Juha-Pekka Weckström, managing director of TeliaSonera Finland, the country's largest phone company, says that remote areas can be covered more efficiently by improving the wireless network rather than laying expensive cable. In 2008, TeliaSonera told 53,000 rural subscribers it planned to convert their traditional copper network, which supplied both voice and broadband Internet, to 3G wireless. It would have cost the equivalent of tens or hundreds of millions of dollars to replace the region's rotting telephone poles, according to Weckström. The Finnish government, eager to ensure that no one would be left behind, made the 1 Mbps decree the next year. TeliaSonera will bid on the government's fiber projects, and is building the Utsjoki trunk line. Weckström says that some of the planned high-speed projects will be unprofitable even with government subsidies, and TeliaSonera will steer clear of those. The Communications Ministry confirms that of the nine high-speed pilot projects now under way, two received no bids.

Karvia, a town in Western Finland, is the site of a project that did receive bids, and Tarja Hosiasluoma, the municipal manager there, is looking forward to getting a fiber connection. It currently takes her half an hour to pay a bill using her plodding, 236 Kbps connection, so it's worth it to her to pay the $1,260 it will cost to hook her home up to the new fiber-optic trunk line. (The actual cost is several times that, but the local and national governments are subsidizing the bill.) About 60 percent of Karvia's 1,100 households will do the same, she says.

Not that Finns are happy about the price. "It's too expensive," says Katekeetta, of Utsjoki. "People who live on the periphery have to pay more to get what others get for free." —*Diana ben-Aaron*

The bottom line *The Finnish government now guarantees fast Internet for all citizens. For those living in rural areas, it still comes at a high cost.*

Quoted

"It looks like the iPhone 4 might be their Vista, and I'm O.K. with that."
—Microsoft Chief Operating Officer Kevin Turner, comparing Apple's latest smartphone to his own company's much-criticized operating system



Legal Fights

Another Suit Over the Spoils of Facebook



▶ A onetime contractor says he's 84 percent owner of the social site

▶ "We are starting to see more and more lawsuits" like this

A lot of people in Silicon Valley scratched their heads this week and asked: Who is Paul Ceglia? A Web designer from sleepy Wellsville, N.Y., Ceglia is hardly a member of the technorati. That didn't stop him from making the claim in a lawsuit that he owned 84 percent of Facebook—and winning a temporary restraining order from a state Supreme Court judge on June 30 freezing the social network's assets. The court's action was based on a contract Ceglia signed with Facebook founder Mark Zuckerberg (above) to do work on an early version of the now-famous entrepreneur's operation in 2003. Legal experts say Ceglia has little chance of prevailing because the Empire State has a six-year statute of limitations on breach of contract claims.

Whatever the case's merits—a Facebook spokesman says it has none whatsoever—attorneys who specialize in technology and intellectual property

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say they've noticed a rise in such claims. "We are starting to see more and more lawsuits involving the ownership of ideas and who has the right to commercially benefit from them," says M. Todd Sullivan, a North Carolina attorney who blogs about trade secrets.

Sullivan points to a complaint filed earlier this year in California by one Errol Hula. Hula claims NBC Universal stole his ideas and used them to create the online video site Hulu with News Corp. after he shared his plans for a similar offering with the company in 2006. Robert Vantress, Hula's attorney, says the most telling evidence in his client's favor is the similarity between Hulu's name and that of his client. "It's too fantastic for me to believe that they came up with that name without it," Vantress says. Hulu declined to comment.

A higher-profile case involving similar claims was the fight last year between Martin Eberhard and Elon Musk, the co-founders of electric-car maker Tesla Motors. Eberhard accused Musk of forcing him out of Tesla in 2007 and taking credit unfairly for the company's creation. The suit was later settled.

Sullivan says these cases are proliferating because the public has never been more aware of the value of an idea. Facebook is worth about $25 billion, according to SharesPost, a marketplace for privately held companies. Zuckerberg, 26, has already duked it out in court with two former Harvard classmates, Cameron and Tyler Winklevoss, who accused him of stealing their ideas. The case eventually settled—and will be reexamined in *The Social Network*, a movie about Facebook's early days coming to theaters in October.

Tech entrepreneurs starting companies in dorms or garages are often as short on business savvy as they are long on dreams, according to Jeffrey Neuburger, co-head of the technology, media, and communications group at law firm Proskauer Rose. That leaves them legally vulnerable, he says: "A lot of them can barely afford to buy lunch, let alone hire a lawyer." Neuburger says most of these matters are settled quickly and expects the same to happen with Ceglia. Ceglia's attorney declined to comment. —*Devin Leonard*

The bottom line *Although a new suit against Facebook has little chance of success, it's part of a growing number of claims over ownership of ideas.*

FROM LEFT: JOSHUA LOTT/REUTERS; CHRIS MUELLER; MATTHEW STAVER/BLOOMBERG; COURTESY TERRAFUGIA (2)

Innovator

Carl Dietrich



The MIT graduate co-founded Terrafugia, which is now taking preorders for the science fiction fan's ultimate dream: a $194,000 flying car

Designing the world's first commercially viable flying car presents unique engineering challenges. One is manufacturing an airplane engine that doesn't overheat when idling in traffic. Another is incorporating both car and aircraft navigation features—steering wheel, control stick, gas and rudder pedals—in a two-person cockpit. The founders of Terrafugia in Woburn, Mass., never doubted they'd get the engineering right. "We always knew we could do it from a technical standpoint," says Carl Dietrich, a co-founder of the company. He'll soon find out whether he nailed the business angle.

In June, Terrafugia (Latin for "escape from land") cleared a significant hurdle when the Federal Aviation Administration granted its car-plane, the Transition, an exemption so that it can include air bags and other car safety features. These devices put the contraption 110 pounds over the normal weight limit for light aircraft. Now the Transition, which weighs 1,430 pounds, or roughly half as much as a Mini Cooper, is a step closer to becoming the first "street-legal plane," as the company's founders call it.

The Transition transforms from plane to car and vice versa in "about the time it takes to lower the top on a convertible," says Dietrich, 33. The vehicle must take off and land at an airport; once in the air, it can range 460 miles at a speed of 110 miles per hour. On the ground, its wings collapse in two and fold along its sides.

The limousine-length Transition can zip along highways at a little over 60 mph. It runs on premium unleaded gasoline, which is both cheaper and more environmentally friendly than jet fuel.

Dietrich started working in earnest on the project in 2004, when the FAA created a new classification for light sport aircraft. The category loosened manufacturing requirements and halved the flight time necessary for a pilot's license to just 20 hours. Those changes, along with advances in composite materials and computer avionics, convinced Dietrich and two co-founders, who met as graduate students at the Massachusetts Institute of Technology, that they could build a flying car and compete in the $1 billion single-engine aviation industry.

Terrafugia has collected more than 80 down payments for the $194,000 vehicle and plans to start deliveries by the end of 2011. Within five years it hopes to produce between 300 and 400 annually.

"I'm sure it'll find a niche," says Richard L. Aboulafia, an aerospace analyst with the Teal Group. "But it has to be for a very rich population in wide-open areas: aviation-minded multi-millionaires in Iowa."

So far, the only person to have flown the Transition is Terrafugia's test pilot, Philip Meteer, a retired U.S. Air Force colonel. The experience, he says, was "remarkably unremarkable." **B**
—*Caroline Winter*



Challenge ▶ Create the world's first commercially viable "street-legal plane"
Background ▶ Met his co-founders in grad school at MIT
Specs ▶ 460-mile range; 110 mph cruising speed; uses premium gasoline

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Markets&Finance

Renters to the Rescue in Miami

▶ **Price cuts help fill condo towers—and revive the city**

▶ **"It's like a bungee cord pulling Downtown businesses up"**



Brandon Klein has done what few Floridians can: go weeks without driving. The 26-year-old tax accountant walks three blocks from his condominium across the street from Biscayne Bay in Miami to his office at **Deloitte**. On weekends, he and his friends hang out on the pool deck or share a cab to a local Irish pub.

He lives in Downtown, a neighborhood north of the Miami River where young people are renting condos built during the 2004 to 2008 boom to attract affluent second-home buyers. The newcomers enjoy a lifestyle made possible in part by developers and banks seeking to recoup some of their losses. Klein and two roommates pay less than $2,800 a month for a three-bedroom unit that has a view of Biscayne Bay, a wraparound balcony, and access to a gym, spa, and steam room. "Five years ago you wouldn't have kids fresh out of college living in luxury like this," says Klein, sitting in the three-story lobby of his building, 50 Biscayne, while coordinating happy-hour plans by text message. Similar apartments sold for as much as $809,000 during the boom, according to Peter Zalewski, a principal with consulting firm Condo Vultures in Bal Harbour.

Many of Klein's friends live nearby in the Met I, which has 447 luxury units and a steakhouse on the first floor. They refer to their building as "Deloitte Dorm" because it's home to so many employees of the accounting and consulting firm.

The 7,000 unsold condos in Miami's core are filling up and giving life to Downtown, an area known for its courthouses, warehouses, homeless shelters, and the American Airlines Arena, where LeBron James will play next season with the Miami Heat. The renewal is even more pronounced in the adjacent neighborhood, Brickell, just south of the Miami River. "I'm a big city person, and I always thought Miami didn't have a real city," said Dejan Krsmanovic, a 39-year-old biomedical engineer who was on a first date at Segafredo, a busy Italian restaurant and bar that opened in 2008 in the Brickell area. "This is beginning to resemble a city."

The new vitality can be seen at Juan Chipoco's sleek Peruvian restaurant, CVI.CHE 105, on Northeast Third Avenue off East Flagler Street, in the heart of Downtown. Chipoco, who recently expanded the restaurant to 220 seats from 65, says lines sometimes form on weekends despite a $10 valet fee and limited parking.

Diners can choose from more than a dozen restaurants north of the Miami River that stay open after 7 p.m., compared with two or three a few years ago, says Jose Goyanes, 42, a longtime Downtown business owner who, with his partners, converted a luggage store into Tre Italian Bistro a year ago. The flood of college students, young professionals, and empty nesters has softened the impact of the recession. "It's like a bungee cord pulling Downtown businesses up," he says.

Alfred Spellman, 31, a documentary filmmaker and lifelong Miami resident, says the new residents and businesses are good for Downtown. He doubts the area will ever be a destination for affluent buyers, though: "In three or four years, when a wealthy couple walks into the lobby of one of these buildings and sees a bunch of college kids, will the

College students, young professionals, and empty nesters have softened the impact of the recession

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$1.25 BILLION

The Icon's cost. The developer lost $50 million to $100 million on the project

7,000

The number of unsold condo units in Miami's core. Many are being rented

Klein (second from left) and friends near the pool at the Icon Brickell

PHOTOGRAPH BY CHRIS MUELLER FOR BLOOMBERG BUSINESSWEEK

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owner of the unit get the price hoped for during the boom? Don't think so."

The influx of renters intensified about 18 months ago when banks that financed the condo projects agreed to let developers slash sales prices by as much as 40 percent, says Zalewski. That spurred demand from foreign buyers and all-cash investors, many of whom are renting out their units until prices rebound, he says.

The Miami Downtown Development Authority estimates that the population of the city's core jumped to about 70,000 from 40,000 since the 2000 Census, with much of the increase coming in the past few years. The Miami rental market is one of the strongest in the country, according to Ronald G. Johnsey, president of Axiometrics, a research firm in Dallas. That's true even though unemployment is more than 11 percent, compared with 9.5 percent nationally, and developers are adding to supply by leasing units built for purchase.

Builders haven't given up on finding buyers. At the Axis on Brickell, developed by **Brack Capital Group**, about 85 percent of the 718 units are rented, says Albert Piazza, the project manager. One-bedrooms go for about $1,400 to $1,600 a month; two-bedrooms cost $1,800 to $2,200. The firm has sold about 239 condos and lets tenants put half their rent toward purchase. "The goal is still to sell out," Piazza says.

"We were trying to build a city in perhaps what was too fast a time period," says Jorge M. Pérez, chairman and chief executive officer of the Related Group. The company has built more than 6,500 units in Downtown and Brickell. Pérez says the **Related Group** lost $50 million to $100 million on the $1.25 billion Icon Brickell, completed in late 2008. The 1,800-unit project has a boutique hotel and a two-acre sundeck 140 feet above Biscayne Bay, featuring three pools, an outdoor fireplace, and an oversize floor chess board. "What we did in building those buildings, was it wrong?" Pérez says. "I wish there wasn't the suffering on a personal basis, on a banking basis, and individual basis. But have we made Miami a much better city? Absolutely, yes." —*Prashant Gopal*

The bottom line *By lowering prices, Miami developers have found a way to fill up empty condo towers while waiting for the economy to rebound.*



Belgium's Reynders: "We want to go for maximum transparency"

Debt Crisis

Getting Stressed About European Stress Tests

▶ A key issue: Where will banks get additional capital if they need it?

▶ "The haircut to Greece looks a little shallow," says one analyst

Global investors will be scrutinizing the results of stress tests for clues to the health of European banks–and they want as much detail as possible. European finance ministers have pledged to oblige when they release results on July 23. "It is clear we want to go to maximum transparency," said Belgian Finance Minister Didier Reynders at a July 13 press conference. Yet European Union finance officials are still debating how much detail from the tests of 91 banks to disclose and how to manage publication of the results.

The European Commission, the EU's executive arm, has warned government officials that failure to publish individual banks' exposure to sovereign debt could damage investor confidence. "There is considerable opposition to the publication of individual exposures to sovereign debt," the Commission said in a confidential letter dated July 9 that was obtained by Bloomberg. "Stepping back" from planned publication of this information "would give the impression that we have something to hide," said the letter, addressed to the EU's Economic & Financial Committee.

"The market is skeptical," Jeroen van den Broek, head of developed-markets credit strategy at ING Groep, told Bloomberg Television. He added that the results "should really highlight the good, the bad, and the ugly banks."

Officials have yet to spell out details of how they would deal with a bank that fails the tests and how additional capital may be provided. Credit Suisse analysts said on July 8 that the "real test" will be the readiness of governments to respond. Speaking at the press conference with Reynders, EU Economics and Monetary Affairs Commissioner Olli Rehn said that banks must raise money themselves before seeking state support. He also said he favors "financial backstops" that would start with national funds. States could then turn to the European Financial Stability Facility set up in May to aid indebted nations, although he does not believe they will need to.

Another issue: Stress tests may not be rigorous enough or assume large enough potential losses, says James Nixon, co-chief European economist at Société Générale in London. Regulators have told lenders the assessments may assume a loss of about 17 percent on Greek government debt, 3 percent on Spanish bonds, and none on German debt, said two people briefed on the matter who declined to be identified.

"The haircut for Greece looks a little shallow," Nixon says, "and the particu-

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lar concern is that if there is a sovereign default in Europe, it will be significantly bigger." Banks globally could lose as much as $900 billion in a worst-case scenario where Greece, Ireland, Italy, Portugal, and Spain all have to restructure their debt, Nomura Holdings estimates. Dutch Finance Minister Jan Kees de Jager has said the stress tests will not include possible sovereign defaults, which he doesn't expect to happen.

In one positive development, Greece sold $2.1 billion of Treasury bills on July 13 at a yield of 4.65 percent. That's below the 5 percent the European Union charged when it lent money to Greece in May to rescue it from default. "It's an encouraging sign that Greece can finance its short-term requirement," says Michiel de Bruin, who oversees $32 billion of European government debt at F&C Asset Management in Amsterdam. "It's a step in the right direction. But it's perhaps too early to say the situation has turned in the euro zone." *—Emma Ross-Thomas, Meera Louis, and Anchalee Worrachate*

The bottom line *Investors want to see details of the stress tests—and to learn how banks that fail them will raise the extra capital they need.*

89

The small business optimism index in June, down from 92.2 in May.

DATA: NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Personal Investing

The Numbers Say Tech Stocks Are Cheap

▶ **The industry's average p-e ratio is as low as it's been in two decades**

▶ **"We're in the midst of a pretty strong earnings recovery"**

Computer and software stocks have slumped to their lowest valuations in two decades, a sign to some analysts that they are poised for a rebound.

Tech companies in Standard & Poor's 500-stock index traded as low as 15.1 times reported annual income this month, according to Bloomberg data. The biggest industry in the index hadn't been that cheap since at least 1992, excluding the six months between Lehman Brothers' bankruptcy and the start of the bull market in March 2009. Using analysts' estimates for 2010 earnings, the group is even cheaper, at 13.4 times projections as of July 13.

As a group, tech stocks trailed the S&P 500 for seven of nine years through 2008. This year they're down 4.6 percent, vs. the S&P 500's 1.8 percent drop. "The technology sector has been overlooked," says Kevin Gardiner, who helps oversee $241 billion as head of global investment strategy at the wealth management division of Barclays in London.

Attractive valuations and renewed tech spending by U.S. companies that are sitting on a record amount of cash may lift shares even if growth slows, according to UBS. Income at tech companies will rise 42 percent this year, compared with 34 percent for the S&P 500, according to the average estimate of more than 2,000 analysts surveyed by Bloomberg. **Intel**, the world's biggest chipmaker, reported record second-quarter sales on July 13 and better-than-anticipated earnings. It also estimated strong sales for the third quarter.

Not everyone believes tech stocks will rally. "My biggest concern is the overall growth of the U.S. economy and of Europe, since those tend to be the largest purchasers of technology," says Brian Jacobsen, chief portfolio strategist for the mutual fund division of Wells Fargo Asset Management, with assets of $465 billion.

Traxis Partners' Barton Biggs, whose flagship fund returned three times the industry average last year, says he sold most of his U.S. technology holdings two weeks ago on signs the economy is weakening.

Others believe tech stocks will shrug off any short-term economic slowdown. "We're in the midst of a pretty strong earnings recovery," says Chip Miller, a New York-based equity strategist for UBS. "Tech fundamentals thus far have remained strong. Given how cheap they are, if you take a little bit of a longer-term perspective, it's probably a good buying opportunity." *—Whitney Kisling, Lynn Thomasson, and Lu Wang*

The bottom line *If companies use some of their abundant cash to shop for computers and related products, tech stocks could see a big bounce.*

Quoted

"Some market participants are overreacting to a couple of reports that have been a bit below what people expected. We had some reports better than expected a couple of months ago. ... This is going to be a recovery that's like that."
—Jeffrey Lacker, Richmond Federal Reserve Bank President



Mutual Funds

A Top Manager Gets Back into Banks

▶ **FBR's David Ellison isn't very concerned about regulatory reform**

▶ **"This is the best time to be making loans I have seen"**

As a young bank analyst at **Fidelity Investments** in the 1980s, David H. Ellison learned a simple lesson from the great mutual-fund manager Peter Lynch: If things at a company are getting better, you want to own its stock. Ellison, who today runs two top-rated financial funds, the $284 million **FBR Small Cap Financial** and the $46 million **FBR Large Cap**

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Markets&Finance



Gen Y is so not into saving page 52 ▶

Economic trends

Wal-Mart Signals the Recovery Won't Stall

Wal-Mart has underperformed the S&P 500 index this year, a sign that investors are betting the economic recovery is intact. Wal-Mart tends to outperform in slumps and lag when the economy rebounds. —*Anthony Feld and Bob Willis*



Financial, says things are improving for banks, especially small ones that can benefit from better credit conditions and consolidation in the industry. "We're in the process of going from ugly to O.K. in banking," Ellison says in the Boston office of **FBR Capital Markets**. "If you ride the right horses, you will do all right."

Prominent investors including Jeremy Grantham and Robert Rodriguez are wary of bank stocks, and star analyst Meredith Whitney has warned that banks will have to post additional reserves to cover real estate losses. Ellison contends that while overall borrowing volume is down, banks are lending to creditworthy customers and earning higher profit margins after competitors such as mortgage companies were wiped out in the financial crisis and housing bust. "This is the best time to be making loans I have seen in my career," he says.



Ellison started putting money back into bank stocks in 2009

Ellison believes the financial-regulatory bill, awaiting Senate approval after being passed by the House on June 30, will have a limited impact on small banks. That's because they don't invest in hedge funds or engage in proprietary trading, activities the legislation is designed to restrict. He has bought more shares in **Washington Federal** and **Provident Financial Services**, two of his top holdings.

The rules will "attack" the profits of some of the biggest banks in the short run, Ellison says. "Over time, will they find a way to work around them? Of course. That is what they do. Considering what the big banks cost the taxpayers, they got off pretty lightly." Among big banks, Ellison favors those with a large base of customer deposits, which provide the companies a cheap and stable source of funding. **Bank of America**, **JPMorgan Chase**, and **Wells Fargo** were the large-cap fund's top positions as of Mar. 31.

Ellison, 52, has run the two FBR funds since 1997. The small-cap fund returned 12 percent a year in the decade ended June 30, second-best among its industry peers behind the **Burnham Financial Services** fund, according to Morningstar. The large-cap fund gained 6.3 percent a year, compared with 2.3 percent for the average financial fund.

Ellison beat 98 percent of his rivals two years ago when he shifted three-fifths of the small-cap fund into cash because he was concerned that rising nonperforming loans would crimp banks' earnings. He started putting money back into bank stocks in early 2009 after concluding that "the world was not coming to an end." The small-cap fund had 94 percent of its assets in stocks as of Mar. 31, data compiled by Bloomberg show.

Ellison contends that a continuing shakeout in the industry will eliminate weak players and allow the surviving institutions to gain size and strength. Consolidation will provide greater benefits to small banks because some may be able to double or triple in size. Says Ellison: "I want Darwin to pick my guys." —*Charles Stein*

***The bottom line** Ellison thinks the worst of the financial crisis has passed and that the small and large banks that survived will be highly profitable.*

Investment Banking

In Initial Offerings, Goldman Is King

▶ The firm is outperforming its rivals for clients and investors alike

▶ "They've come under fire, but it doesn't matter"

Goldman Sachs, the Wall Street firm accused by the U.S. government of defrauding investors in mortgage-backed bonds, is doing well by companies it helps take public–and the people who invest in them.

The 11 American companies that used Goldman as their primary underwriter for initial public offerings in the U.S. got the highest prices for their shares in the first half of 2010, selling them at an average 1.4 percent discount to their target price, data compiled by Bloomberg show. Companies that hired other banks to lead their IPOs took an average discount of 14 percent for their shares.

Buyers of IPOs managed by Goldman were rewarded with an average first-day advance of 9.6 per-

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cent, more than double the average 3.6 percent advance for initial offerings arranged by other banks. IPOs led by **Credit Suisse** and **JPMorgan Chase** were discounted by an average of 21 percent and had the smallest first-day gains, Bloomberg data show. "The issuer and investor care about the opposite things, and the investment bank is in the middle," says Steven Kaplan, professor of finance at the University of Chicago's Booth School of Business. "Goldman appears to have done very well" balancing the interests of both groups.

Goldman is outperforming its competitors in a field that is one of Wall Street's most lucrative. Bankers charged 6.4 percent of the money raised for underwriting U.S. IPOs in the first half of this year, earning $580 million on 53 offerings, data compiled by Bloomberg show. While most IPOs are arranged by two or more banks, the primary underwriter typically commands the biggest share of the fees, according to Roni Michaely, a finance professor at Cornell's Johnson Graduate School of Management.

Goldman helped **Financial Engines**, the investment advisory firm co-founded by economics Nobel laureate William Sharpe, become the first U.S. company in 2010 to price its shares above the target range, raising $146 million. The provider of portfolio management services to people with employer-sponsored retirement plans leaped 44 percent on its first day, the biggest jump of any U.S. company this year, after selling shares at $12 each in March.

The bank enjoyed its IPO success even after the Securities & Exchange Commission sued the bank for allegedly selling mortgage-related securities that were designed to fail. Goldman Sachs calls the SEC's lawsuit "completely unfounded."

"Goldman is clearly the king investment banker," says Timothy Loughran, a finance professor at the University of Notre Dame's Mendoza College of Business in Indiana, who has studied IPOs for 20 years. "They've come under fire, but it doesn't matter. If you're an issuing firm, that's the first firm you would go to." Ⓑ —*Michael Tsang*

***The bottom line** Despite being sued by the SEC, Goldman Sachs held a dominant position in one of Wall Street's most lucrative client businesses.*

Bid & Ask

By Cristina Lindblad



Real Estate

The housing crisis has reached Wildcat Ranch, a luxury development near Aspen, Colo. A 501-acre spread (above) owned by cookie mogul Debbi Fields and her husband, Michael Rose, ex-CEO of Holiday Inn, has been on the market since September 2008. Asking price: **$28.5 million.** Music executive Tommy Mottola's five-bedroom log "cabin," meanwhile, was listed last month at **$27.5 million.**

Human Resources

$4.9bn

The sum Aon agreed to pay for Hewitt Associates, a firm that advises companies on employee pay and benefits. The acquisition by the insurance broker will give rise to the world's largest human resources service company. The HR field is consolidating: Towers Perrin and Watson Wyatt completed a $4 billion merger earlier this year.

Timber

$5.6bn

The amount Weyerhaeuser is distributing to shareholders via a special dividend. The largest owner of U.S. timberland is converting to a real estate investment trust, a move that will shield most of its earnings from taxes. U.S. law mandates that firms making such a transformation pay out all retained earnings and profits in the first year.

Telecom

Tyco Electronics is paying **$1.24 billion** for ADC Telecommunications, which makes broadband equipment that helps companies and consumers connect to the Web. Switzerland-based Tyco Electronics is the world's largest maker of electronic connectors used in cars and appliances. The acquisition will boost Tyco's sales in the U.S. and China, where Minnesota-based ADC has a strong presence.



Art Market

An 1839 landscape by J.M.W. Turner fetched **$45.1 million** at a Sotheby's auction in London, setting a record for the British artist. The canvas depicting some of Rome's most famous monuments once belonged to the Rothschild family. Its new owner is California's J. Paul Getty Museum.

Cars

How much will speed freaks have to shell out for a car that last month set a world record for street-legal cars of 268 miles per hour? Almost **$2.5 million.** The specs on the new Bugatti Veyron Super Sport include a 16-cylinder engine, a twin-clutch gearbox with seven speeds, and an all-carbon body. The car will go into production this fall. But don't dawdle: The first five to roll off the company's Alsatian assembly line are already spoken for.





Direct Selling

Seeking to expand beyond cosmetics, Avon is paying **$650 million** for Silpada Designs. The direct seller of sterling silver jewelry has annual sales of about $230 million in the U.S., Canada, and the U.K.

Banking

Santander is paying **$699 million** for 173 German bank branches owned by Sweden's SEB. This is but the latest in a long list of acquisitions for Spain's largest lender. Earlier this year it purchased $3.2 billion in auto loans from Citigroup and bought back almost a quarter of its Mexican unit from Bank of America for $2.5 billion. Santander is also bidding for about 300 bank branches in the U.K. owned by RBS.

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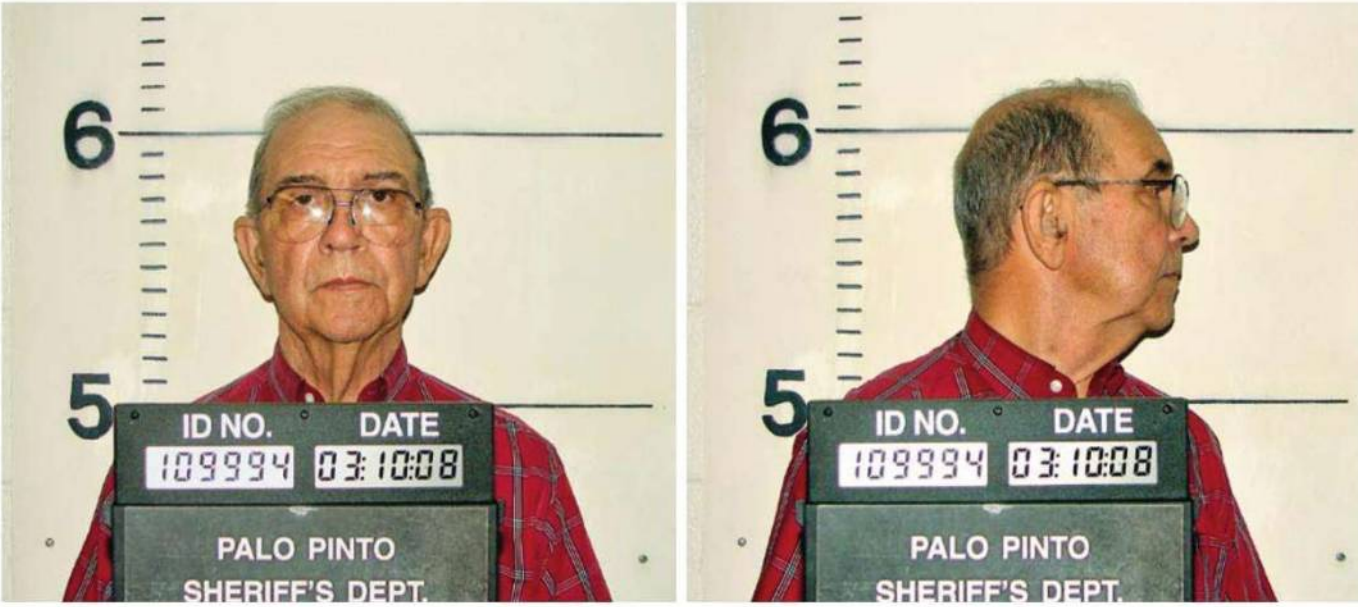
Morningstar *FundInvestor*, March 2010. Morningstar evaluated the 25 largest fund groups (based on asset size) on the following measures: manager retention rates over the last 5 years; fund management tenure (how long the portfolio managers have managed their funds); fund managers' investment in the fund they manage; 3-year asset-weighted performance of their retail share classes; and Morningstar Stewardship Grades, which evaluate a fund group's culture, fees, Boards of Directors, manager incentives, and regulatory records. Data used were as of 2/28/10 except for manager retention, which is through 12/31/09.

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Focus On **Retirement**



Senior Swindlers: A Sucker Retires Every Minute

▶ **More seniors are victims of financial fraud—and the elderly are often the scammers**

▶ **"It's astounding that you can't even trust older people anymore"**

Annuities. Reverse mortgages. Life insurance pools. Principal-protected notes. The options being offered to senior citizens hoping to ensure a comfortable retirement are dizzying. And in a growing number of cases, that may be the intention as more scammers–often elderly themselves–try to con retirees. Though hard numbers are difficult to come by, many lawyers and advocates for the elderly say more seniors than ever are being lured into investment schemes that are unsuitable for people of their age or are outright swindles. "Seniors who suffer from isolation and diminished capacity make ideal targets," says Steve Riess, a San Francisco attorney who represents elderly victims of con artists peddling bogus investments.

One out of five Americans over the age of 65 has been the victim of a financial scam, according to the Washington-based Investor Protection Trust, a nonprofit that promotes shareholder education. That means more than 7.3 million seniors have been taken advantage of financially through inappropriate investments, high fees, or fraud, which insurer **MetLife** says comes at a cost of more than $2.6 billion a year. "Older people are being targeted because, as 1930s robber Willie Sutton said when asked why he robs banks, 'that's where the money is,'" says Kathleen Quinn, executive director of the National Adult Protective Services Assn. in Springfield, Ill.

Many of today's scammers have a particularly good understanding of their victims–because the fraudsters themselves are of retirement age, if not exactly retired. More elderly con artists than ever seem to be preying on retirees, perhaps because senior citizens put more confidence in someone their age, says Denise Voigt Crawford, president of the North American Securities Administrators Assn. "It's astounding that you can't even trust older people anymore," Crawford says.

Congress may crack down on advisers calling themselves specialists in investments for seniors

In November, William Kirshner, 84, a financial adviser in Corpus Christi, Tex., was sentenced to five years in prison for stealing more than $100,000 from senior citizens and other clients who invested in promissory notes issued by his company. Ronald Keith Owens (above), 74, was sentenced to 60 years in prison in January 2009 for persuading investors, including retirees, to put more than $2.6 million into nonexistent bank-related investments. And William Walter Spencer, 68, a Franklin (Tenn.) financial adviser, sold elderly members of his church promissory notes that turned out to be bogus. He pleaded guilty to fraud in May and is expected to be sentenced in August.

Veterans are a big target. Several groups offer to help former soldiers sign up for a $2,000-a-month ben- ➔

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efit from the Veterans Affairs Dept. in Washington. While the program is real, some groups are telling seniors they can only qualify if they liquidate their assets and purchase an annuity, which usually comes with a hefty sales commission.

Reverse mortgages, which let people aged 62 and older get cash out of their homes and are repaid when the borrower dies or moves, are a big part of many scams. One popular ruse is urging the elderly to finance annuity purchases with a reverse mortgage, despite a ban on cross-selling them with other financial products. Other unsuitable investments being pushed on seniors are pools of life insurance policies, similar to the bundles of home mortgages that helped fuel the financial crisis. Some of these have turned out to include policies that don't exist, and it's unclear whether they're supposed to be overseen by state insurance regulators or the Securities & Exchange Commission.

Principal-protected notes are another investment being pushed on the elderly, says John Gannon of the Financial Industry Regulatory Authority in Washington. He says seniors fall for these because the name makes it sound as if they're risk-free; in fact the principal isn't always protected, as holders of notes backed by Lehman Brothers learned when the firm collapsed. "Financial professionals, both legitimate and illegitimate, know there are assets seniors have that they can get their hands on," Gannon says. "They've figured out ways to get to all of them."

The new financial regulatory reform bill would crack down on advisers who market themselves as specialists in investments for seniors, and another measure would include harsher penalties for anyone committing securities fraud against the elderly. "We need better regulation of this industry," says 75-year-old Senator Herb Kohl (D-Wis.), who heads the Senate's Special Committee on Aging, "so seniors can tell the difference between professionals who offer clear and unbiased financial advice and bad actors... who steer them toward inappropriate financial products." —*Alexis Leondis*

The bottom line *More retirees than ever are being targeted by financial swindlers, many of whom are themselves elderly.*

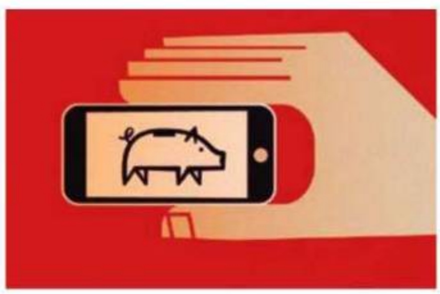
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"The new concept of retirement involves people working, off and on, from their mid-60s into perhaps their 80s. It will be as significant a shift in labor dynamics as we had with women entering the workforce, and it will give the U.S. a major competitive edge."
—Andy Sieg, head of Bank of America Merrill Lynch retirement and philanthropic services



Long-Range Planning

Gen Y's Empty Piggy Bank



▸ **Fund managers woo younger workers, but few pay attention**

▸ **"This generation lacks confidence about making financial decisions"**

Baby boomers fretting over their pensions should spare a thought for Constance DeCherney. Like many of her generation, the 27-year-old Web strategist at Planned Parenthood in New York has done little to prepare for retirement. While she became eligible for a 401(k) in 2005, DeCherney only began putting money into it last year. She now contributes 3 percent of her pay, though that's just half of what Planned Parenthood will match, and DeCherney doesn't know how the investments are performing. "Just the idea of [saving for retirement] feels overwhelming," she says. "My fear of doing something wrong, or not doing enough, sort of paralyzes me."

DeCherney is typical of America's so-called Generation Y, the twenty-somethings who have entered the workforce in the past 10 years. Already saddled with student debts averaging almost $20,000, according to New York-based think tank Demos, Gen Y is in a tougher financial position than previous generations. The average salary for 25- to 34-year-olds, for instance, fell 19 percent over the last 30 years, after adjusting for inflation, to $35,100, Demos estimates. That's if they can get jobs: Unemployment among 19- to 24-year-olds stands at 15.3 percent vs. the overall rate of 9.5 percent, according to the Bureau of Labor Statistics. While many of their parents have guaranteed retirement income from being in a company-funded pension for part of their careers, Gen Y is "the first do-it-yourself retirement generation," says Catherine Collinson, president of the Transamerica Center for Retirement Studies in Los Angeles.

Investment companies are stepping up efforts to engage Gen Yers in retirement planning. **Charles Schwab** has revamped its website to include weekly advice for younger workers on everything from retirement planning to paying down debt. **Vanguard** is testing out social media, using more blogs, a Facebook page, and soon, **Twitter**. "It's how this younger generation learns," says Vanguard Chief Executive Officer William McNabb III. **Fidelity**, the nation's largest 401(k) administrator, in June launched an iPhone app for tracking retirement savings and has replaced bulky pension literature with e-mail updates. "This generation lacks confidence about making financial decisions," says Beth McHugh, Fidelity's vice-president of market insights. "You have to explain why planning for retirement is so important."

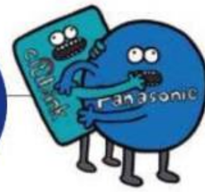
That's presuming you can get their attention. Fewer than 4,000 Facebook users have clicked the "like" button for Fidelity's page and about 9,000 have done so for Vanguard's. Meanwhile, 4.2 million people say they like **Apple** iTunes on Facebook. Schwab, which began sending Twitter feeds in mid-June, has 277 followers. **Whole Foods Market** has 1.8 million.

Some baby boomer parents enlist the help of their financial planners in giving their kids a retirement reality check. Jim Stoops, a Schwab financial consultant in Chicago, says his 250-plus clients often bring their sons and daughters to his

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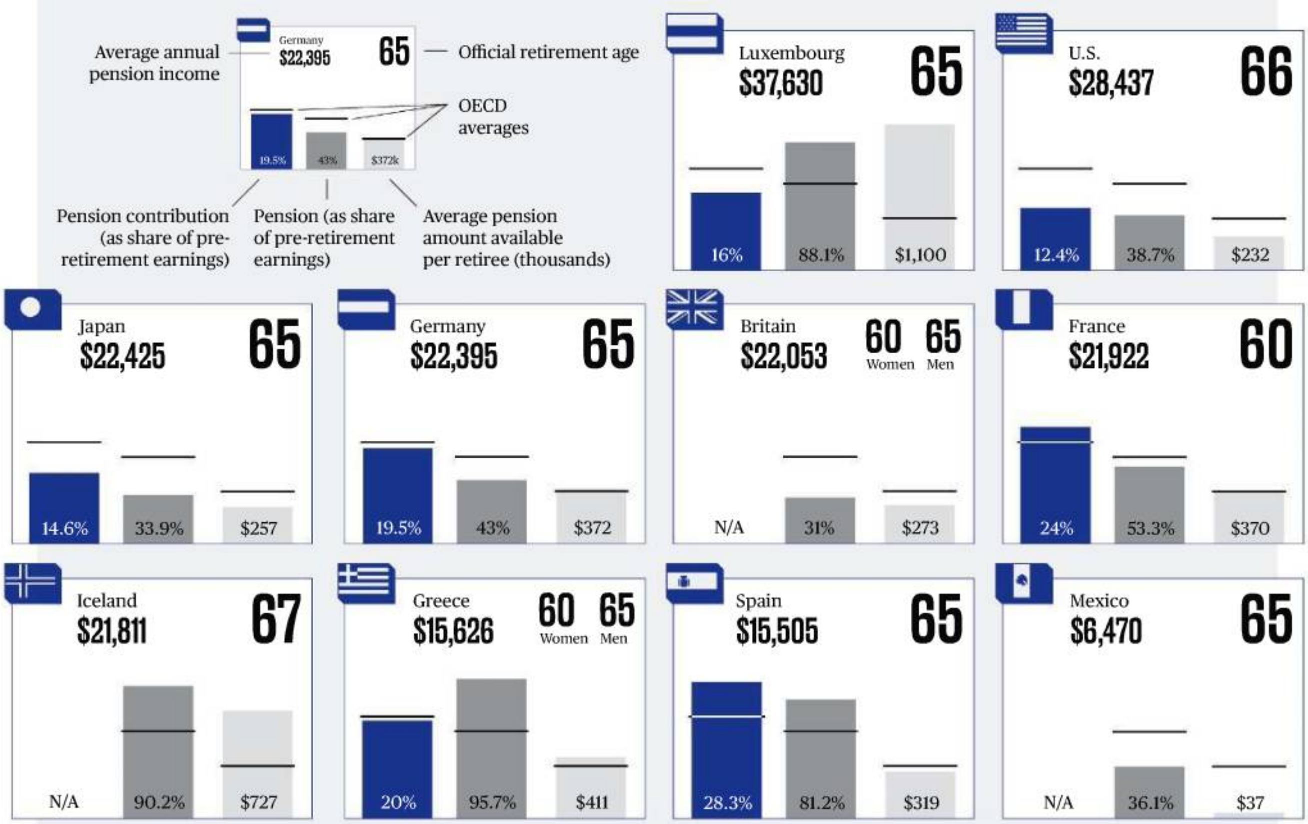
What do social media directors do? page 64 ▶



Global Perspective

A World Tour of Retirement Plans

Which country has the sweetest deal for retirees? Here's how 10 industrialized nations stack up in terms of state-funded pensions, excluding 401(k)-type programs. —*Mark Scott*



DATA: ORGANIZATION FOR ECONOMIC COOPERATION & DEVELOPMENT

office for advice. "Parents just can't believe how difficult retirement will be for their children," he says. "They're trying to instill financial values in their kids."

Changes in the way 401(k) plans are designed may help the retirement prospects of Gen Y. Growing numbers of companies automatically enroll employees in plans rather than requiring them to sign up to establish an account, which has helped double participation to roughly 80 percent of eligible workers since 2006, according to the Employee Benefit Research Institute in Washington. (More than half of the U.S. labor force, though, works at companies that don't offer 401(k) plans.) More companies also use so-called auto-escalation programs that bump up contributions over time. And most 401(k)s now offer target-date funds that automatically adjust the investment mix to less volatile securities such as bonds as an investor ages.

Still, the best solution for Gen Yers who want a comfortable retirement is old-fashioned. "The trick is to be incredibly disciplined about saving early," says Vanguard boss McNabb. His proposal: "An addendum to the basic principles of investing that reads: 'I am not kidding.'"
—*Mark Scott, with Suzanne Woolley, Chris Prentice, Moira Herbst, and Matt Robinson*

The bottom line *Young workers lack the pensions their parents enjoyed, and few are setting aside enough for retirement via 401(k)s and similar plans.*

Pension Reform

In Europe, a Longer Wait For the Gold Watch

- ▶ **Governments are raising retirement ages as they seek to cut deficits**
- ▶ **"Europe is in a fantasy world," says pension expert David Blake**

Mamadou Doukowu had planned to retire in 2016 and start a life of leisure on a state pension. Now, it appears the 54-year-old Paris security guard may have to wait a bit longer to hang up his badge. President Nicolas

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Speed Dial

Savings Strategies

Money manager and *The Investor's Manifesto* author William Bernstein on the challenges of investing well for a comfortable retirement

What are investors up against in managing their retirement money?
I believe most folks are about as capable of managing their retirement portfolio as they are of flying their own airliners or taking out a relative's appendix.

Yet a lot of people do manage their own money—by choice or necessity. How can they invest their savings better?
Deal only with fundholder-owned companies (or company—Vanguard) or one of the more reputable exchange-traded fund providers, such as iShares. Use only low-cost, passively managed funds: Performance comes and goes, but expenses are forever. Last year's or the last 10 years' winner is no more likely than average to excel next year or next decade. Don't overestimate your risk tolerance. How well you do depends not on how you do in normal markets but on how you act when the storm breaks.

Err on the side of underinvesting in stocks. Only when you've demonstrated you can buy when there's blood in the street should you increase your equity allocation. A prudent mix of stock funds, high-quality bond funds, and perhaps low-cost single-premium annuities is all you really need.

Many planners run computer programs called Monte Carlo simulations to judge the probability of portfolio returns under various scenarios. Is that useful?
Somewhat, but it can give a false sense of security. Among other things, it assumes you get normally distributed returns—that you don't have these big market meltdowns like we've seen in recent times. And it assumes investors have the discipline to stick with the plan during a 1929-32 or a 2008-09.

Rather than relying on Monte Carlo simulations, I'd suggest a simple rule: If you're a 60-year-old withdrawing 2 percent of your retirement savings annually, you'll be as safe as can be; at 3 percent, you're probably safe; at 4 percent, you're taking real risks; at 5 percent, you've a good chance of an Alpo diet. (At 70, you can perhaps add 1 percent to 1.5 percent to these numbers.)

One other recommendation: If you have a reasonable life expectancy, delay taking Social Security until you are 70; it is the cheapest, safest "annuity" you can "buy." Yes, if you die before age 82 or so, you "lose." But losing by living too long with inadequate income has far more serious consequences. B
—*Suzanne Woolley*



Retirement

Sarkozy wants to raise France's retirement age from 60 to 62 as he grapples with a soaring deficit. "If you've worked for 40 years, your body is tired," Doukowu says as he directs trucks into a Paris construction site. "I've paid into the system. They owe it to me."

Politicians from Athens to Madrid have targeted pension reform as a way to offset government debt. No wonder. According to the Organization for Economic Cooperation & Development, state pensions in Europe can reach 95 percent of preretirement earnings, vs. 39 percent in the U.S. from Social Security payouts (though many Americans can tap into private 401(k)s and similar tax-deferred options available to few Europeans). Retirement ages are often lower than in the U.S.: Greeks who have worked 35 years can get a full pension at 58 despite an official retirement age of 65. Says David Blake, director of the Pension Institute at Cass Business School in London: "Europe is in a fantasy world" when it comes to retirement.

With nearly everyone in Europe eligible for a public pension, governments know they need to get people to spend more years on the job. Currently, there are four workers for every retiree in Europe. That ratio will halve by mid-century as the population ages, the OECD says. The change risks leaving Europe without enough tax revenue to pay for lush pensions. "Working longer is the only solution for avoiding old-age poverty," says Monika Queisser, head of the OECD's social policy division.

As part of an austerity plan demanded by the International Monetary Fund, Greece aims to make people retire later and is curbing automatic bonuses that retirees get at Christmas, Easter, and during the summer. Spain is proposing to stop inflation-linked increases in pensions and to raise its retirement age from 65 to 67. And British workers may soon have to wait until they turn 68 before they can start getting their full pension.

The overhaul could ease the burden on public finances. The changes in France will add $24 billion a year to government coffers as pension handouts drop and income taxes rise, the Labor Ministry says. Even a one-year increase in Britain's retirement age would add $19.5 billion annually to the national budget, says Chris Curry, research director at the Pension Policy Institute in

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Strikers in Athens on July 8 protest changes in the pension system

London. "There's real fiscal pressure to change the system," he says.

Unions across the Continent have taken to the streets to protest the new rules. On June 23, French workers held more than 200 demonstrations nationwide. A strike in Madrid on June 29 led to clashes with police. And Greece has been rocked by a half dozen general strikes this year, shutting down airports, ferry service, banks, and hospitals. Unions fear blue-collar workers, particularly those in hazardous industrial jobs, will suffer the most under the pension changes. "We want to overturn these harsh and antisocial measures," says Spyros Papaspyrou, head of Greece's civil servants' union.

With Europe's unemployment rate at 9.6 percent and rising, keeping older people on the job longer will make it harder for the young to get hired. And some employees already give up their work due to medical or personal reasons well before public pensions kick in. That means governments may need to pick up health-care costs and even some welfare benefits, so the savings from later retirement could be less than expected. "Many people stop working because they've just had enough," says Krzysztof Hagemejer, coordinator of social security policy at the International Labor Organization in Geneva. "Raising the retirement age won't solve that problem." *—Mark Scott, with Carol Matlack and Natalie Weeks*

The bottom line *As European governments seek to cut budget deficits, they're planning to raise the retirement age and trim pension benefits.*

Investment Portfolios

Changing the Art of Retirement Down Under



▶ **Australia wants savers to invest conservatively—so paintings are out**

▶ **"Maybe it's not the best climate to unload. It's bad policy"**

Mixing art and commerce has always been tricky. It's getting trickier in Australia, where workers can stock their retirement savings accounts with paintings and sculptures. "I grew up with art all around me. It's my life. I love it," says John Cruthers, a 56-year-old Sydney resident who has amassed more than 100 artworks to help fund his retirement.

Australia's government may order him to ditch the lot. Proposed pension rules would put curbs on Australians who manage their own retirement savings by investing in art and may even require them to sell their collections within five years.

Artists, exhibitors, and buyers in Australia predict the change would cause job losses, gallery closings, and a slump in prices. Galleries rely on so-called do-it-yourself pension funds for as much as 20 percent of annual sales in the $561 million market, according to Save Super Art, a group campaigning against the proposals. "The goalposts have been moved," says Cruthers, who had planned to sell his works between 2020 and 2030 to cover living expenses. He may now have to sell much earlier for less than he was expecting. "It's really unjust." Adds Jason Benjamin (bottom left), a Sydney-based artist who supports retirement investing in art: "My work is expensive now. It hasn't always been. It doesn't climb out the window one day and say, 'I'm valuable now.'"

The art proposals are part of a broad review of the country's system of retirement accounts, or "supers" as Australians call them. Australians must set aside a minimum of 9 percent of salaries for old age. Jeremy Cooper, the review chair and former deputy chairman of Australia's markets regulator, has said he wants self-managed funds to focus on traditional investments such as stocks and bonds rather than paintings, stamps, wine, and golf club memberships. "These assets lend themselves to personal enjoyment and a range of 'non-investment' factors," he wrote in the report.

Because regulations stipulate pension assets may not be used until retirement, it's illegal in Australia for individuals who hold art in self-managed funds to show their paintings or other works at home, though they can be leased to galleries for display. Cooper wants to block art from pension portfolios to ensure the rule isn't abused, says Sharyn Long, chairman of the Self-Managed Super Fund Professionals' Association of Australia, which represents 420,000 accounts with about $337 billion in assets.

Michael Reid, who runs a 19th century gallery in Sydney's Elizabeth Bay, recently tried and failed to sell two Aboriginal works for a client who was concerned he may have to divest the works if the proposals become law. "People have said, 'I'm reviewing my super now and I'll unload it,'" Reid says. "Maybe it's not the best climate to unload. It's bad policy." Ⓑ *—Angus Whitley*

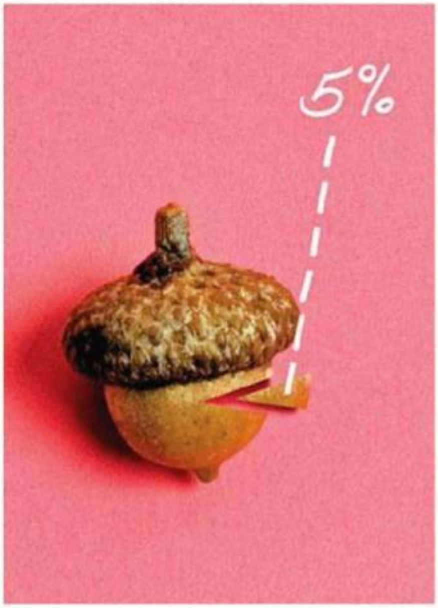
The bottom line *Australians investing in art for retirement face a potential shift in rules that could force them to sell their collections.*

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Teresa Ghilarducci

Focus On Retirement

I'll Say It Again: Dump the 401(k)



The 401(k) has been a failure. Let's replace it with new Guaranteed Return Accounts that could be made available to all workers

Google my name, and you'll see my photo next to a blog calling me "the most dangerous woman in America." Why does a *U.S. News & World Report* blog put me up there with Typhoid Mary and Octomom? In October 2008, just as the financial crisis was gathering steam, I told a congressional committee that it's time to reinvent the 401(k). I suggested a government-guaranteed alternative consisting of diverse and prudent assets such as blue-chip stocks and corporate and Treasury bonds. "The 401(k) is a failure," I told the House Committee on Education & Labor. "I want to spend our nation's dollars for retirement better."

Over the past 30 years, workplace pensions have morphed from defined-benefit plans (in which the company pays retirees a set amount every month from retirement to death) into defined-contribution plans such as 401(k)s, which are primarily funded by deductions from salaries. In a perfect world, an average worker could amass something like $400,000 in a 401(k) by retirement. After nearly three decades of 401(k) contributions, though, the average account balance for people nearing retirement age is about $60,000, far less than what's needed. So it's no surprise that when a recent Gallup poll asked what Americans want most from government, more chose guaranteed pensions than guaranteed jobs or health care.

Most people save less than 5 percent of their income for retirement, and many start withdrawing funds early because of layoffs, divorces, and other unexpected events. The consequence of these 401(k) leaks is that workers retiring in 15 years will do worse than their parents and grandparents, according to the Center for Retirement Research at Boston College. Almost two-thirds of households will probably face declining living standards in retirement.

Taxpayers are shouldering far more of these leaky retirement boats than anyone imagines. All the tax-free contributions going into 401(k)s, Keoghs, and other retirement schemes reduce federal tax receipts by $193 billion a year. And almost 80 percent of the tax breaks go to the top 20 percent of taxpayers.

So let's scale back the tax breaks. Instead, we can use the money to help everyone sock away 5 percent of their pay in safe retirement accounts that would serve as a universal supplement to Social Security. People could keep their employer plan if it met more stringent standards such as a contribution rate of at least 5 percent, a ban on early withdrawals, and conversion into an annuity at retirement. Anyone without an employer plan would automatically be enrolled in a Guaranteed Retirement Account to which employees and employers would each contribute 2.5 percent. The government would then provide everyone a modest tax credit to offset the employee contributions. The return would be guaranteed by the government at about 3 percent above the rate of inflation—or close to the real growth rate in gross domestic product.

Tax-free contributions to retirement plans reduce federal tax receipts by $193 billion a year

The key to this proposal is pooling individual accounts. These would be professionally managed, but with trillions of dollars in the pools, management fees would be lower than on conventional retirement accounts. That means every dollar in tax breaks would translate into almost a dollar in retirement income instead of going toward fees or being diverted to other purposes by people who make withdrawals before retirement. National savings would get a boost. All Americans, including the 64 million who have no pension plan, would get one at no extra cost. What's not to like?

A lot, apparently. After I finished my congressional testimony, I got so many screaming death threats and nasty e-mails that my employers at The New School in New York became alarmed, and the security chief gave me his cellphone number. But as the economy continues to slump, discussions of my plan and a half-dozen or so similar proposals have become less vitriolic. There is a recognition on both the Left and the Right that people simply have to set aside more for retirement. And to make that happen, they have to be required to sock away more. B

Ghilarducci is a professor at The New School for Social Research and author of When I'm Sixty Four: The Plot Against Pensions.

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Teachers' Pest

The Bill & Melinda Gates Foundation is betting billions that a business approach can work wonders in the classroom. And that where the carrot doesn't work, the stick will. By Daniel Golden

It's been two years since Bill Gates left his day-to-day role at Microsoft to concentrate on supervising the Bill & Melinda Gates Foundation—and his new enterprise is booming. Headquartered in a converted check-processing center in Seattle's Eastlake neighborhood, the 10-year-old foundation plans to move into a 900,000-square-foot campus and visitors' center near the city's Space Needle next spring. The Gates Foundation opened a London office this year; it also has offices in Washington, Delhi, and Beijing, and 830 employees around the world, up from about 500 in 2008. With assets of $33.9 billion as of Dec. 31, 2009, and America's two richest people—Gates and Warren Buffett—as trustees, the foundation plans to spend $3 billion in the next five to seven years on education. If there's such a thing as a charity behemoth, the Gates Foundation is it.

While its efforts in global health are widely applauded, its record in America's schools has been more controversial. Starting in 2000, the Gates Foundation spent hundreds of millions of dollars on its first big project, trying to revitalize U.S. high schools by making them smaller, only to discover that student body size has little effect on achievement.

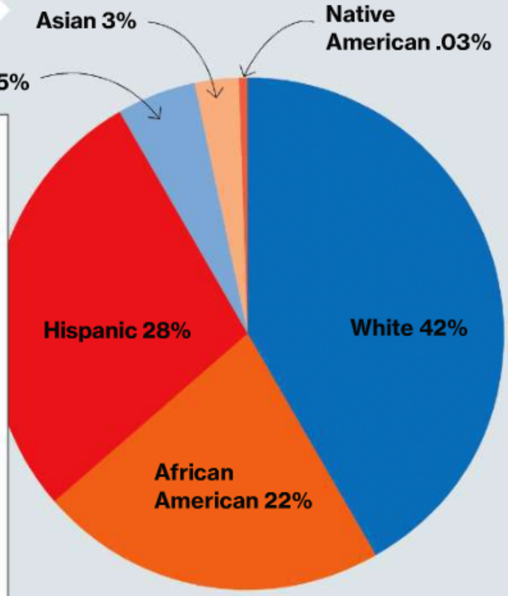
It has since shifted its considerable weight behind an emerging consensus—shared by U.S. Education Secretary and Gates ally Arne Duncan—that quality of teaching affects student performance and that increasing achievement is as simple as removing bad teachers, identifying good ones, and rewarding them with more money. On this theory, Gates is investing $290 million

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Racial breakdown of Hillsborough County schools in October 2008



over seven years in the Tampa, Memphis, and Pittsburgh school districts as well as a charter school consortium in Los Angeles. The largest chunk of money, $100 million, will go to Tampa's Hillsborough County school district, the eighth-largest in the U.S., with 192,000 students and 15,000 teachers. These carefully selected programs, which will favor or penalize teachers depending on whether students make larger or smaller gains than their test scores in prior years would have predicted, are intended as models that, if proven successful, can be rolled out nationwide.

The Gates agenda is an intellectual cousin of the Bush Administration's 2002 No Child Left Behind law, which required all public schools—though not individual teachers—to make "adequate yearly progress" on student test scores. Some opponents of No Child Left Behind questioned its faith in data; are scores too narrow a gauge of how well kids are learning? Gates sees nothing wrong in relying on quantitative metrics. "Every profession has to have some form of measurement," he said in a late June interview with *Bloomberg Businessweek*. "Tuning that, making sure it's fair, getting the teachers so they're enthused about it" are the keys.

Still, the prospect of such measurement makes some educators and academic researchers uneasy. They contend that factors such as school leadership and culture exert a powerful influence on student achievement. Moreover, rating individual teachers based on their classroom's test results may be better suited to little red schoolhouses than today's large urban schools, where teachers team up, aides and tutors pitch in, and students come and go frequently.

While cities such as Denver and Cincinnati have experimented with paying teachers for performance, the Gates initiative—called Intensive Partnerships for Effective Teaching—marks the largest and most comprehensive effort to evaluate teachers in all grades and subjects based on student test gains. "The people at Gates believe there is a window right now," says Michael S. McPherson, president of the Spencer Foundation, which supports education research. "They have in Washington an Administration that's broadly sympathetic to their view. They have the attention of the American people, wanting dramatic improvement in the schools. Bill and Melinda Gates want to see results—not just in their lifetimes, but in the next few years."

"We've got to work with the unions.... That takes a lot of up-front work, but it's crucial"
—Melinda Gates

Small schools, false start

The last thing you'd expect from an organization headed by Bill Gates is a math mistake. Yet, according to Wharton School statistician Howard Wainer, the foundation may have misread the numbers when it arrived at its first prescription for American education. Wainer, who used the foundation as a case study in his 2009 book, *Picturing the Uncertain World*, says it seized on data showing small schools are overrepresented among the country's highest achievers and started pouring money into creating small high schools and subdividing big ones. Tom Vander Ark, a former schools superintendent in Washington State who was tapped to oversee the foundation's educational arm, was—and remains—a booster of small schools. The Gates Foundation declined comment on Wainer's assertion and research.

From Pierre S. du Pont, who gave more than $6 million to train teachers and build 120 public schools in Delaware in the 1920s, to the Rockefeller family, which funded child development research that helped lay the groundwork for the Head Start program, corporate leaders have long promised to ride to the rescue of public education. One of the highest-profile efforts came in 1993, when publisher Walter Annenberg gave $500 million—matched by $600 million in gifts from other sources—to strengthen urban, rural, and arts education, only to be stymied in some school districts by rapid changes of leadership and direction.

In the past, says University of Michigan historian Maris A. Vinovskis, benefactors "were not as prescriptive about how they wanted their money spent." Now a new generation of philanthropic billionaires, including Gates, homebuilding and insurance entrepreneur Eli Broad, members of the Walton family that founded Wal-Mart Stores, and former hedge fund manager Julian Robertson, want public education run more like a business. Charter schools, independent of local school districts and typically free of unionized teachers, are one of their favorite causes. "We don't know anything about how to teach or reading curriculum or any of that," Broad said last year at a public event in Manhattan. "But what we do know about is management and governance."

Small schools promised an alternative to the impersonal bureaucracy of traditional high schools, which Gates in a 2005 speech proclaimed "obsolete." But according to Wainer, adherents overlooked a troublesome fact: Small schools are overrepresented among the lowest as well as highest achievers. Why? Because the smaller a school, the more likely its overall performance can be skewed by a few good or bad students.

Wainer says big high schools, for all their problems, outperform small ones. Scale lets them offer more advanced classes, electives, and extracurricular activities. With Gates funding, one Denver high school split into three and lost so many students that it shut down in 2006. It reopened a year later as a single school, without the foundation's support.

In November 2008, Bill Gates publicly backtracked, acknowledging in a speech in Seattle that "simply breaking up existing schools into smaller units often did not generate the gains we were hoping for." Still, the foundation has not re-

PREVIOUS PAGE: PLATON/ART DEPT/CPI SYNDICATION. DATA: HILLSBOROUGH COUNTY PUBLIC SCHOOLS

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> "The Gates people are dramatically more attentive to evidence"
>
> —Michael S. McPherson (President, Spencer Foundation)

nounced its original mission. Gates credits its smaller schools for their proficiency at boosting attendance and decreasing violence. "So we absolutely believe in the small schools thing," he says. "Calling that a failure is not fair."

The experience taught the foundation the value of humility. "The Gates people are dramatically more attentive to evidence," says McPherson of the Spencer Foundation, "and more willing to consider that they need to keep learning than they were when they started out."

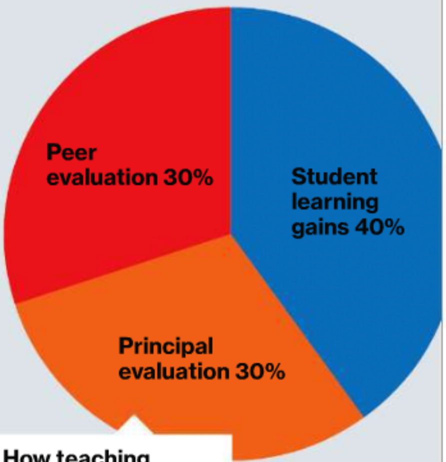
As it became clear that small schools alone weren't the solution, Gates installed new leadership, naming Vicki Phillips, who served as Secretary of Education for the State of Pennsylvania and superintendent of schools in Portland, Ore., to replace Vander Ark in 2007. After a yearlong reassessment, Phillips swung the foundation behind the next big wave in education reform—evaluating teachers based on student test score gains. One of her key moves was enlisting Harvard University economist Thomas Kane as deputy director of education for data and research. Kane had co-authored an influential 2006 study of 150,000 students in grades 3-5 in Los Angeles that analyzed just how vital teacher quality is to student performance. Having a teacher ranked in the top 25 percent four years in a row "would be enough to close the black-white test score gap," the study found. It made a strong recommendation seemingly borrowed from corporate America: Teachers who ranked in the bottom quarter after their first two years in the classroom should be fired.

The Gates-funded plan in Tampa will put teachers on the spot starting this school year. Of the $100 million that the foundation is pouring into the Hillsborough County school system, at least $60 million will go to teachers. With that cash comes a new evaluation system: 40 percent of the grade will be based on student learning gains as measured by standardized tests, 60 percent on observations by the school principal and teachers from elsewhere in the district. Highly rated teachers could earn as much in their fourth or fifth year as colleagues with 20 years' experience who opt to stick with the traditional pay scale. The aim is to spur teachers to adopt best practices and learn from colleagues who are more effective in handling disruptions or instilling particular concepts, according to Gates. "It's an incentive to identify the exemplars," he says. Teachers at the bottom will have to improve or face immediate consequences. "We anticipate there will be teachers who are no longer in the profession in Hillsborough County," says schools superintendent MaryEllen Elia. "They will be told, 'This is not the place for you.'"

Hillsborough currently terminates one-half of one percent of its teaching force annually. More than 99 percent of Hillsborough teachers were rated satisfactory or outstanding in 2007-2008, and 98 percent of those eligible received tenure. So how will a group that's received almost nothing but positive reviews react to a more rigorous evaluation based on student improvement? One logical response is to narrow instruction to the content and techniques needed to pass tests, at the cost of encouraging creativity, curiosity, or complex analysis. "This is likely to take teaching to the test to a new level," says Harvard education professor Daniel Koretz.

Wainer, the statistician who spotted the mathematical fallacy behind the small schools movement, is also skeptical. "It's conceivable you could get a value-added score to work at an elementary level, but how can you do it at a high school?" he asks. "How should my physics gain score match against your French score? Was Mozart a better musician than Babe Ruth was a hitter?"

Judging teachers on student performance creates a litany of such practical problems, from how to assess progress in subjects such as art, shop, or phys ed to accounting for the mobility of inner-city families. In Memphis, where Gates has invested $90 million, schools superintendent Kriner Cash says one-third of students move during the year, which means their gains can't necessarily be credited to one school, much less one teacher. Giving several tests a year can sort out each teacher's contribution, he says. Still, ratings may be tainted if frequent transience requires teachers to integrate newcomers and adjust to departures.



How teaching will be evaluated beginning in fall 2010

Teacher report cards

Studies of teacher effectiveness show much variability. Few instructors stay at the top or bottom statistically year after year. A study of five Florida districts from 2000 to 2005, including Hillsborough, found that only half the teachers ranked in the top 20 percent one year were in the top 40 percent the next. Tying teacher jobs to student gains "isn't as simple and straightforward as some people think it is," says Gene Wilhoit, executive director of the Council of Chief State School Officers in Washington, a recipient of Gates funding. "We're a bit concerned that others aren't raising these kinds of issues. We're also concerned, if you do raise these issues, it's seen as making excuses or pulling back from commitments."

Gates' approach risks alienating teacher unions, which typically have negotiated pay based on seniority and advanced degrees. In April, under union pressure, Florida Governor Charlie Crist vetoed a plan that would also have tied teacher salaries to test score results. When Bill Gates addressed the national convention of the 1.5 million-member American Federation of Teachers on July 10 in Seattle, a small group of teachers walked out, though he also received several standing ovations. "One of the things that we learned through the small schools initiative is that we've got to work with the unions," Melinda Gates told *Bloomberg Businessweek*. "That takes a lot of up-front work, but it's absolutely crucial."

As a condition of funding, the

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foundation required Hillsborough and the other districts to cooperate with local unions. In a union-friendly move, Hillsborough agreed to tell teachers in advance when peers will observe their lessons, making positive evaluations more likely. By contrast, in a nationally acclaimed program in Cincinnati, teachers give two lessons before evaluators without prior notice.

"If you tell teachers ahead of time that they're going to be observed, they'll just say to the class, 'O.K., kids, somebody's coming in, I expect you to behave, raise your hand when you ask a question, and if you do well we'll have a party the next day,'" says JoAnn Parrino, a teacher at Chamberlain High School in Tampa. "The only way to tell a good teacher is to go into their classroom spontaneously."

David Steele, chief information and technology officer for the district, says the decision to notify teachers was made because it didn't want to "play gotcha." Also, he says, a pop-in can waste the evaluator's time: "What if the teacher is showing a movie that day?"

Despite the opportunity to increase their income, teachers nationwide are skeptical of Gates' agenda. In a national survey of 40,000 teachers co-sponsored by the Gates Foundation and released in March, 36 percent said that tying pay to performance is not at all important in retaining good teachers, while only 8 percent said it's essential. And 30 percent said it would have no effect on student achievement—triple the proportion that said it would have a very strong impact.

"The Gates Foundation was very surprised," says Randi Weingarten, president of the American Federation of Teachers. "They asked the question in a way they thought they'd get a positive result, and they got a very negative result." On the contrary, says Gates spokesman Christopher Williams, the foundation was heartened that a significant portion of teachers do believe in merit pay.

In 2007, a year after the foundation gave $21.6 million to Chicago public schools, Melinda Gates toured the system with its then-chief, Arne Duncan. "I was extremely impressed with what he was doing," she says. "We started our relationship then."

Friends in Washington

Today, the Gates Foundation and Education Secretary Duncan move in apparent lockstep. Two of Duncan's top aides, Chief of Staff Margot Rogers and Assistant Deputy Secretary James H. Shelton III, came from the foundation and were granted waivers by the Administration from its revolving-door policy limiting involvement with former employers. Vicki Phillips, who heads the foundation's education programs, and Duncan participated from 2004 to 2007 in the Urban Superintendents Network, a group of a dozen school leaders who met twice a year at weekend retreats co-funded by Gates.

When the federal government made $4.35 billion in federal Race to the Top awards available—favoring applicants that agree to link teacher pay to test score gains, increase the number of charter schools, and adopt common curriculum standards—the Gates Foundation paid for consultants to prepare applications for 24 states, as well as the District of Columbia. One of two winners announced so far is Tennessee, which had help from Gates. The state will receive about $500 million from the Obama Administration.

The Gates Foundation, which bankrolled development of the common curriculum standards, is also funding outside evaluations—by the Thomas B. Fordham Institute in Washington and the state board of education—of those same standards. The Boston-based business group is expected to release its report before the Massachusetts Board of Elementary & Secondary Education meets on July 21 to choose between the new standards preferred under Race to the Top and revisions to existing state criteria, considered among the most rigorous in the country.

Williams, the Gates spokesman, says the foundation frequently pays for independent assessments of its programs and doesn't seek to dictate their conclusions.

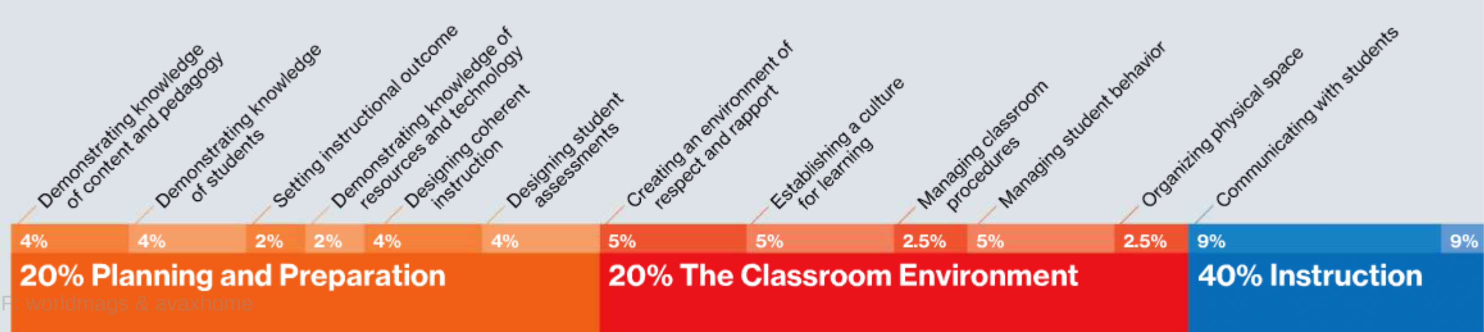
"The Gates folks are well aware of our independence and, I think, incorruptibility," says Chester E. Finn Jr., president of the Fordham Institute, a nonprofit education think tank. Still, Finn says, the alliance between the government and the country's richest foundation could discourage dissent. "I've become suspicious of the phrase 'public-private partnership,'" he says. "It comes off the tongue as an undisputed good thing. It's actually a disputed good thing."

As a private entity that doesn't answer to voters, Gates can back initiatives that are politically dicey for the Obama Administration, such as uniform standards, says Jack Jennings, director of the Center on Education Policy. In the past, states' rights advocates have blocked federal efforts for a national curriculum. Gates "was able to do something the federal government couldn't do," Jennings says.

At the same time, the rapport between the federal government and the largest private education funder is raising concerns that competing ideas are getting squeezed out. "It's like a mind meld between Arne Duncan and the Gates Foundation," says former U.S. Assistant Education Secretary Diane Ravitch, whose 2010 book, *The Death and Life of the Great American School System*, criticizes Gates for exerting "vast power and unchecked influence" over American education. If she had access to resources like Gates', says Ravitch, she'd save parochial schools that have been effective for inner-city kids but are suffering from church cutbacks.

The alliance between the Gates Foundation and the government raises other issues, too. Drew Gitomer, a researcher with the Educational Testing Service, says the foundation may be rushing a $45 million study that involves videotaping math, English, and biology lessons by nearly

How a Teacher Gets Graded—and Paid



DATA: HILLSBOROUGH COUNTY PUBLIC SCHOOLS

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Hillsborough lets teachers know when peers will observe lessons—making positive evaluations likelier

3,000 teachers in the just-ended and upcoming school years. (The project lets teachers watch their lessons–and student reactions to them–to identify effective techniques, like football coaches breaking down game film.) The foundation plans to preview its findings this fall, which could help state Race to the Top winners design teacher evaluation programs.

The study "is very much fast-tracked," says Gitomer, whose role in the study is to assess teachers. "There's a feeling this is the opportune time. In a better world, it might have been nice to pilot some of these things. There's some risk associated with moving that quickly."

Phillips says the foundation maintains "appropriate firewalls." While members of its staff testify before Congress and keep tabs on federal and state policy, the foundation doesn't lobby or influence government decisions on grants, she says. Asked whether the appointment of Brad Jupp, a senior program adviser at the Education Dept., to an advisory committee for the Gates teacher videotaping study violated the foundation's firewalls, Phillips said, "It's one of those fine lines we walk constantly." When the foundation approached Jupp, he initially expressed interest in serving on the committee, he said in an e-mail. After *Bloomberg Businessweek* asked Phillips about it, Jupp declined the position. He said he changed course on the advice of the department's ethics counsel.

Both Melinda and Bill Gates contest the notion that there is anything amiss in the foundation's relationship with the federal government. All the foundation wants is results, says Bill Gates, however they are achieved. "If people have particular ideas for improving schools, those experiments will get funded," he says. Duncan's spokesman, Peter Cunningham, says the foundation's agenda "is very much aligned with the Obama Administration agenda. We partner with them on a whole host of things."

Selling the plan

If Hillsborough district official Anna Brown had been graded on her May presentation to teachers at Tampa's Chamberlain High School about the Gates plan, she would have gotten an incomplete. One teacher of 12th graders wanted to know if she would be penalized for senior slump. Music instructors questioned the district's decision to evaluate them on their students' grasp of music theory instead of instrumental proficiency. Brown got thoroughly grilled about the new system and didn't have all the answers.

Kathy Jones, a 35-year veteran who teaches Advanced Placement world history, asked how the district could measure her students' improvement since they don't take a prerequisite course or a pretest. When Brown said PSAT scores as well as exams in other social studies courses could provide a baseline, Jones scoffed: "I don't see how it's even possible."

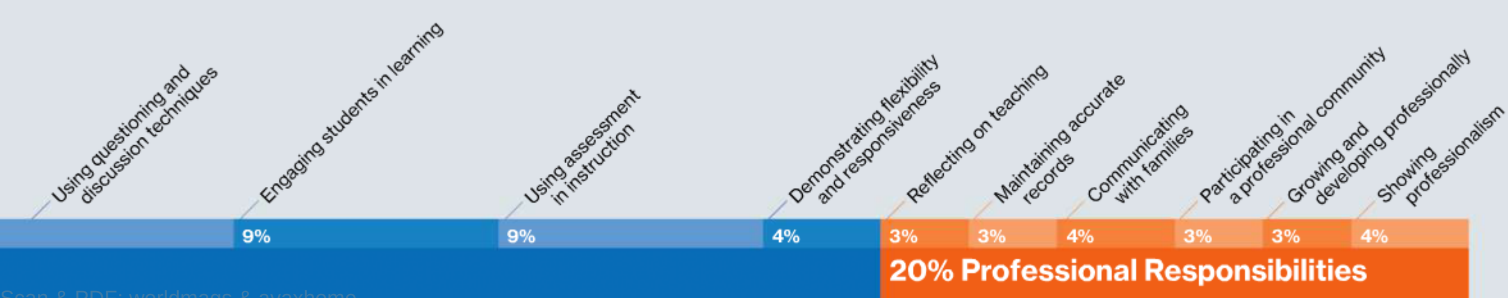
The testy atmosphere illustrates the challenges for Hillsborough–and the Gateses–as they translate theory into practice. The foundation has worked hard to bring teachers on board. Gates is paying $1,500 apiece to more than 600 Hillsborough teachers whose lessons are being videotaped. Says Cassie Schroeder, an eighth-grade language arts teacher at Giunta Middle School in Tampa: "I put it toward my credit cards."

Hillsborough teachers complain that they already have a pay-for-performance plan, and they don't like it: the State of Florida's Merit Award Program, which gives 5 percent bonuses based on student test score gains in the prior year. Because of limited funding, teachers within each subject compete for awards. Arlene Castelli, principal of Giunta, says teachers are embarrassed to win the bonuses. "If you can't boast about an award, what good is it?" she asks. "I don't like pitting teachers against each other."

That, in the end, is one of the major worries about the Gates plan: that it will encourage teachers to think narrowly in their own interests, to not only "teach to the test" but also refrain from the cooperative efforts that are essential to the education process. At Giunta, two-thirds of the 1,134 students in sixth through eighth grades are black or Hispanic, almost three-fourths come from poor families, and low achievers in math take two classes, regular and intensive, with different teachers. Before state testing in March, students on the bubble of passing or failing–about 20 percent of each grade–attend extra sessions with teachers who drill them on their weaknesses. Like a baseball player who won't bunt to advance a teammate, a teacher may think twice about giving a student extra help if a colleague gets the credit–and the pay raise. "We don't want teacher evaluation to get in the way of student achievement," says Castelli. "Who's to say the parents didn't work with the children at night? Who's to say the child didn't mature? Or the child blew off the test the year before?"

Shrugging off "the commune-type approach," Bill Gates says that excellence demands individual accountability. In his speech to the American Federation of Teachers, Gates struck an evangelical tone as he appealed for faith in his initiative. "You owe it to your profession and your students to make sure that tenure reflects more than the number of years spent in the classroom," he said. "It should reflect the quality of the work you do in the classroom."

Later, he added: "Sometimes the most difficult act of leadership is not fighting the enemy; it's telling your friends it's time to change." Ⓑ



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Twitter, Twitter, Little Stars

Layoffs? Not in the social media departments of corporate America. As customers make or break brands online, companies are rushing to hire social media directors... and figure out what they do.

By Felix Gillette. Illustrations by Al Murphy

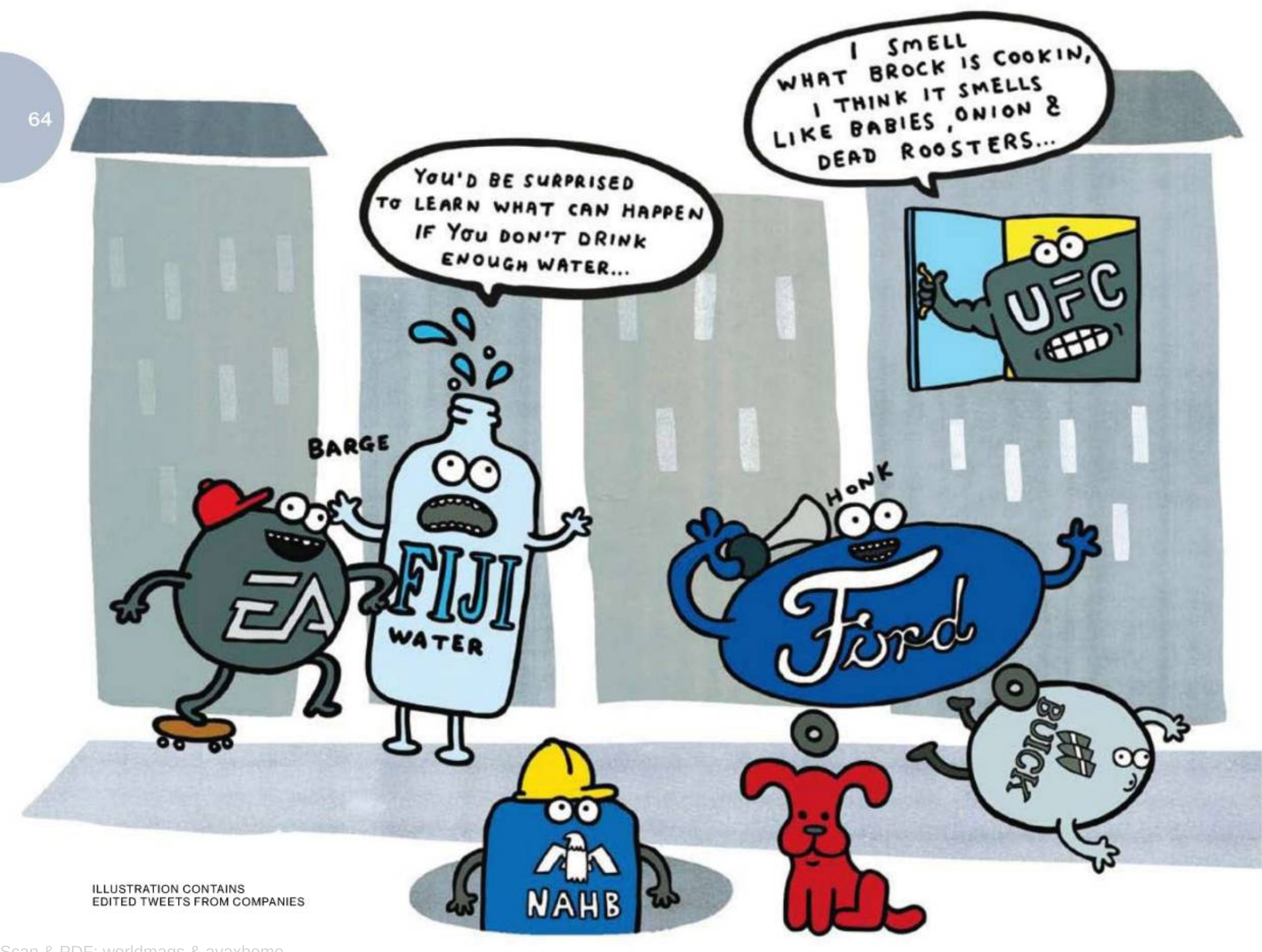


ILLUSTRATION CONTAINS EDITED TWEETS FROM COMPANIES

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Natalie Malaszenko has always loved pets. A 31-year-old resident of San Diego, Calif., she has a dog named Sarge and a cat named Leo. Years ago, when she lived in Texas, she took care of cows and horses and even a stray emu. In recent months, however, since beginning a full-time job at the pet retailer Petco, she has taken on the additional responsibility of tending to a breed of notoriously unruly carnivores, capable of scaring off even the most patient caregiver–namely, online commenters. So far, Malaszenko says she loves them, too.

Earlier this year, Petco executives appointed Malaszenko to a new–and trendy–job: director of social media and commerce. Across the country, companies like Petco are going through a two-step process. First, they scramble to hire social media officers. Second, they figure out what it is, exactly, that social media officers do. Blending departments–promotion and marketing, customer service and support–and requiring the ability to be shameless boosters while maintaining a light, self-aware tone, the job category is experiencing a boomlet as companies try to keep up with the new media world. The chief social media officer may be



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supplanting the chief branding officer as the zaniest human resource innovation in memory.



"It's about making money" Natalie Malaszenko, Petco

Malaszenko's initial assignment was to envision and articulate Petco's social media strategy for the future. "How do we take the great passion that people have for their pets and do something with it in social?" she asks, using the corporate shorthand for social media. "As a team, we figured out that for us it means being a part of these discussions, regardless of where they're happening." To that end, Malaszenko now curates multiple Petco fan pages on Facebook, several Twitter accounts, and the company blog, called The Petco Scoop. "Raising pets is really challenging," she says. "Dogs pee on the carpet. Cats scratch furniture. How do you help people through it and not necessarily say, 'this is the expert advice,' because we all have different opinions. We're just bringing the opinions together and harvesting [them] into a community."

The ultimate goal of her social media team, says Malaszenko, is to help the bottom line. "It's about having a conversation," she says. "But it's also about using social to influence purchase decisions. ... For us, it's about making money, as well."

Opportunities in corporate social media are popping up faster than cat videos on YouTube. In addition to Petco, in the past few months, Sears Holdings, Panasonic, the Fifth Third Bank, the National Association of Homebuilders, Citigroup, Electronic Arts, AT&T, Fiji Water, GoDaddy.com, and the Ultimate Fighting Championship have all sought or hired social media experts. In Las Vegas, Harrah's Entertainment recently circulated a job listing for a "corporate social media rock star." In Chicago, Buick went looking for a handful of "social media ambassadors" to help manage Tweet to Drive, which allows customers to schedule test drives from home via Twitter. At the same time, traditional public relations and marketing powerhouses such as Ogilvy & Mather are bulking up their expertise to fend off social-media-focused startups.

Much of the justification for the corporate spending, however, is anecdotal. As company chiefs find themselves chasing another new, new thing in the digital world, they are doing so as much on faith and emotion as on metrics and case history. The hiring spree satisfies two key constituencies: chief executives who can now reassure themselves that they have someone in-house dedicated to catering to fickle, Web-surfing consumers, and self-styled experts in the American workforce finding a way to capitalize on the corporate fever for Internet-a-go-go, Web 2.0.

Pete Cashmore, who runs the blog Mashable, is a sort of life coach to the social media industry. Recently he declared June 30 to be Social Media Day. Teaming up with Meetup, a website that enables online communities to have face-to-face get togethers, Mashable helped its readers organize some 700 celebratory powwows in more than 90 countries around the world. In Manhattan, a crowd packed into The Mean Fiddler, a bar in Times Square, to network with their peers over $4 draft beers. At the back of the room, a manager for an eco-consulting firm swapped social media stories with a creative director for a watch wholesaler. Jeanette Espinosa, a 25-year-old "social media project manager," introduced herself to a chatty group and said she did social media work on behalf of an agency that represents various liquor brands. "It's an absolutely booming industry," says Cashmore, whose site includes robust job listings. "There are more positions than people right now. There are a lot of companies waking up to it and realizing that they need to have a social media strategy."

A long professional track record is not necessarily a prerequisite. Curtis Hougland, the founder of Attention, a New York-based specialist in social media PR and marketing, says the supply of seasoned candidates has failed to keep pace with demand. As a result, a swarm of self-proclaimed social media rainmakers has appeared at job interviews, aiming to parlay a high number of Facebook friends or Twitter followers into salaried positions with benefits—all of which is vaguely reminiscent of the frenzied hiring during the first Internet boom in the late 1990s. "There's a tremendous amount of B.S.," says Hougland. "The company hiring may not have the sophistication in social to verify the person's experience. They may be personally really active on Twitter and have a great blog, but it doesn't mean that they understand how to apply it to a business context."

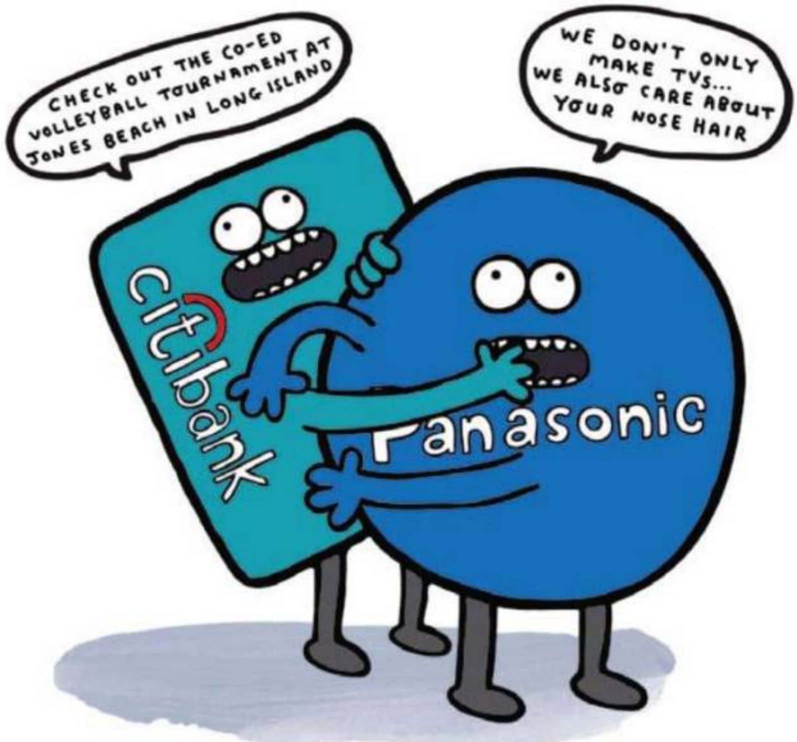
When Malaszenko talks about being part of discussions, regardless of where they are happening, she is not being hyperbolic. Social media experts spend much of their time monitoring software platforms, like Radian 6, that track what is being said about their companies or products in every nook of the Web. The strategic challenge is then to address the rants and raves. While the rules of engagement vary, the general strategy is to amplify the affection, creatively disarm the reasonably disgruntled, and ignore the unhinged. Accepted norms in the analog world don't necessarily apply. After all, if the medium were, say, the telephone, parachuting in on other people's conversations about your company would be considered creepy. Not so on social networks, at least from the companies' point of view, where being intrusive without seeming intrusive amounts to a crucial quality in a social media director.

In the current environment, complaints can go viral fast. Nobody wants to become the next United Airlines, which took a beating last year after ignoring a frustrated passenger, a musician who eventually posted a song on YouTube about the airline breaking his guitar. The video has been viewed more than 8 million times and no doubt helped inspire more than one queasy PR department to consider hiring a social media strategist.

When they're not out practicing Twitter jujitsu, social media managers craft companywide guidelines and also proselytize within the ranks. Some employees inevitably balk at the idea of tweeting about their jobs because it sounds suspiciously like more work. Others worry—often rightfully—about oversharing themselves into trouble. Last year, James Andrews, a vice-president at the PR firm Ketchum flew to Memphis to talk to employees at FedEx, one of the agency's largest clients, about digital media. Shortly after arriving in Memphis, Andrews wrote on his Twitter account, dubbed @keyinfluencer: "True confession but I'm in one of those towns where I scratch my head and say, 'I would die if I had to live here.'" Someone at FedEx noticed the sideswipe and took offense, touching off a storm that resulted in an embarrassing public apology on behalf of Ketchum executives. (Andrews did not respond to an e-mail seeking comment.)

Just as people sometimes type more than they should, companies rolling out a new product on social media can quick-

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ly lose control of their message. Last year, prior to launching the 2010 Accord Crosstour, Honda set up a Facebook fan page for the model. Instead of attracting praise, however, the forum soon blew up with critical comments knocking the design of the new car, which, in turn, drew a bunch of snarky media attention and plenty of negative buzz.

Jim Durbin, the creator of socialmediaheadhunter.com, says experienced social media directors–business strategists capable of identifying a company's needs and solving them using social media tools–can command $120,000 a year and up. Further down the ladder are community managers, who oversee a company's day-to-day social media operations and earn $60,000 to $80,000. Below them are cub Twitter managers, essentially copywriters with little business experience, who typically earn $30,000 to $50,000. The higher-paid directors are often required to justify their salaries with progress reports to upper management and sometimes must fight for the respect and acknowledgement they feel they deserve. Metrics used to evaluate success in corporate social media might include: number of Tweets; number of re-Tweets (a Twitter message that's resent by a follower); instances of "customer recovery," in which an irate civilian is successfully mollified; an increase in the number of Facebook fans or Twitter followers; and the number of photos of your product that have been posted online. "We look for opportunities to take our fans and give them more reasons to share their fandom and express their love for the brand," says Rick Wion, the director of social media for McDonald's. Wion says he is currently crafting a measurement scale that would compare his metrics to the company's traditional media efforts.

Because most of the tools of the profession are free, the new class of social media managers can find themselves stuck with meager operational budgets. One solution is to team up with flush neighbors in the marketing department to create campaigns aimed at converting relevant social media "influencers" (anyone with a bunch of followers anywhere online) into "brand ambassadors" through the strategic deployment of free stuff.



"[People trust] people like themselves"
Scott Monty, Ford

Earlier this summer, for instance, Princess Cruises hosted roughly a dozen Twitter-loving travel hobbyists on an 11-day "cruisetour" through Alaska. It's hard to put a value on the results; Rick Griffin, owner of a site called The Midlife Road Trip Show, tweeted to his 20,000-plus followers: "My 'boat ride' was incredible!! Had the time of my life and I gained about 12 pounds :)."

Similarly, Ford Motor last year handed over advance models of the Ford Fiesta to a hundred social-media-savvy "agents." In a press release, Ford described the agents as "witty, irreverent, and adventurous" enthusiasts who were "socially outgoing, and more than happy to share their opinions" with fellow "Millennials, the next-generation consumer group born between 1979 and 1995." Recently the company announced that if it can get 30,000 people to "like" the Explorer on Facebook, it will give away a 2011 model.

The genre of corporate Twitter writing does not, as a rule, lend itself to brilliance. Noteworthiness is not the goal. Diligence and volume tend to be the yardsticks by which one's opus is measured. The prolific Scott Monty, head of social media at Ford, is often cited by his peers as a luminary of the field. On a recent Thursday he oversaw 12 updates on the Ford general Twitter account, eight on the Ford customer-service Twitter, two posts on FordDriveGreen Twitter, and one on FordMustang Twitter. That same day, Monty wrote 38 Ford-related posts on his own Twitter account. Most were aimed at other posters, creating in sum a long string of half-conversations, all of which were successfully innocuous and perfectly forgettable.

"People don't trust corporations as much as they used to," says Monty. "They trust third-party experts, and they trust people like themselves." He believes that Ford's social media strategy is "humanizing" the company by using platforms like Twitter. "Ultimately, it's the most personal of all the social networks," he says. "It's one-on-one communication in the public square. It gives a person the satisfaction of having interaction with a big company like Ford and of being listened to. And it also shows the public that we're listening and that we get it."

As Ford and others listen harder, the social media job category, which hardly existed five years ago, should continue to attract refugees from various sputtering corners of the economy. A decade ago, Malaszenko could hardly have predicted that she'd now be heading up Petco's social media practices. "This is a career path that I sort of fell into," she says. "I originally was working on a PhD in cognitive neuroscience." Ⓑ

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L'Affaire Sarko



Illicit campaign cash, secret tape recordings—what began as a money fight inside the family that founded and controls L'Oréal has entangled the French President

By Carol Matlack with Helene Fouquet

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On a chilly evening in March 2007, about 40 people gathered at the Crowne Plaza Hotel near the Geneva International Airport. The crowd consisted mostly of French expatriates working in Switzerland's private-banking industry, and they came armed with their checkbooks: Eric Woerth, treasurer of France's center-right UMP party, was holding a fund-raiser for Nicolas Sarkozy's Presidential campaign. Most of the guests made donations of €3,000 to €4,000 apiece, recalls Nicolas de Ziegler, a Geneva-based asset manager who helped organize the evening. "It was completely transparent," he says, "utterly banal." It reflected Sarkozy's promise of "*une rupture*," a clean break with the history of political slush funds and illicit cash payments that had tainted the campaigns of Presidents from François Mitterrand to Jacques Chirac. Woerth, who had turned UMP's fund-raising

into an efficient, professionally managed operation, seemed to personify a hopeful new era.

Three years later, Sarkozy finds himself in the midst of a crisis that endangers his Presidency—and Woerth is in the thick of it. A legal dispute involving Liliane Bettencourt, the billionaire heiress to the L'Oréal cosmetics empire, has metastasized into a political scandal replete with allegations of illicit campaign cash, tax evasion, and clandestine Swiss bank accounts. The French press is feasting on the details, which include secret recordings made by Bettencourt's butler and leaked testimony by her former accountant. Woerth, who became Sarkozy's Budget Minister and is now Labor Minister and point man on pension reform, the most important legislation of the President's five-year term, has been accused by the former accountant of taking covert cash from Bettencourt for Sarkozy's campaign. Woerth and Sarkozy have denied the accusation, and no charges have been filed. The President, though, is scrambling to control the damage, which has helped drive his approval ratings to as low as 26 percent.

Looking drawn and subdued, Sarkozy took a seat on the Elysée Palace terrace on July 12 to answer questions about the scandal in a television interview aired on the state-owned France 2 network. "They've accused me of going to get money from Madame Bettencourt. That's a disgrace," he said. He also reminded viewers that a government inquiry had already cleared Woerth of one potentially serious charge, intervening in Bettencourt's tax affairs while the then-Budget Minister's wife was working as a financial adviser to the Bettencourt family.

Still, Sarkozy asked Woerth to step down as party treasurer and said he would name a commission to study how to avoid potential conflicts of interest. "I promised to create a republic above reproach," he said, "and that is what we are doing."

While it has landed squarely on the doorstep of the President, the trouble began with a relationship between a man and a woman—specifically, according to a criminal complaint filed in 2007, between the 87-year-old Bettencourt and a man 24 years her junior, François-Marie Banier. A celebrity photographer who has taken pictures of Johnny Depp, Karl Lagerfeld, and Queen Elizabeth II, Banier befriended Bettencourt and her late husband, André, after a photo shoot in 1987. He has been charged with "abuse of frailty" in an attempt to extract more than $1 billion in cash and gifts from her, including real estate and paintings by Picasso and Matisse. If convicted, he faces up to three years in prison and €375,000 in fines. Shortly before Banier's trial was scheduled to begin in June, the tabloid magazine *Paris Match* published photos taken between 1999 and 2006 showing the elegant Madame Bettencourt whispering in Banier's ear at a café in Istanbul, dining with him in Tokyo, and walking arm-in-arm with him on a tropical beach in the Seychelles Islands. Banier's lawyer has said that Banier is innocent. He argues that the heiress's estranged only child, Françoise Bettencourt-Meyers, who filed the charges, was driven to do so by jealousy. "I am perfectly aware of my actions and do not need to be taken care of," Bettencourt said in a statement released on July 14.

Although the case involves the family's private finances, it also raises questions about Liliane Bettencourt's role at L'Oréal, the world's largest cosmetics company, which was founded in 1909 by her father, Eugene Schueller. Bettencourt owns 30.2 percent of the public company and serves on its board; the Swiss food giant Nestlé owns 26.4 percent. Under a complex 2004 agreement, neither side can sell any of its holdings without giving the other the right of first refusal. Bettencourt has promised not to sell her shares during her lifetime, but if Banier is convicted, Bettencourt-Meyers may seek to declare her mother mentally incompetent and take control of her assets. L'Oréal shares have risen 63 percent during the past year, in part because of speculation about a possible takeover by Nestlé. The prospect of a French company with $21.9 billion in sales and 65,000 employees falling into foreign hands made the case politically sensitive even before Sarkozy became enmeshed in it.

Banier's expected summer trial was delayed by a startling discovery. In June, Bettencourt's former butler, Pascal Bonnefoy, turned over 21 hours of CDs he had secretly recorded from May 2009 to May 2010 in the sitting room where Bettencourt received visitors to her mansion in the Paris suburb of Neuilly-sur-Seine.

Set against the genteel sound of teaspoons clinking on porcelain, the recordings include discussions about tax evasion, nepotism, and backdoor contacts between Bettencourt's representatives and government officials; both Woerth's and Sarkozy's names come up often.

Woerth's wife, Florence, worked for a Bettencourt-owned company called Clymène—from the ancient Greek word for "famous woman"—that managed the heiress's holdings. In talks captured by Bonnefoy's recorder, Clymène's director, Patrice de Maistre, informs Bettencourt that he hired Florence Woerth at the request of Eric Woerth, whom he describes as "a friend." Portions of the recordings—the authenticity of which have not been disputed—have been leaked to French media outlets.

At the time Florence Woerth was hired by Clymène, her husband was leading a government campaign against tax evasion—a subject of considerable concern to Bettencourt's financial advisers. In recordings made last year, de Maistre explains plans to avoid the crackdown by closing Bettencourt's Swiss bank accounts and moving €65 million to Singapore, where it would be harder for authorities to track. "This has to be cleaned up by Christmas," he told her in a conversation from last November, referring to tax enforcement measures that took effect at the end of 2009. Florence Woerth, who quit her job with Clymène in late June after the scandal broke, has said she was unaware of any attempts to avoid taxes. In a report made public on July 11, France's General Financial Inspection office concluded that Eric Woerth never intervened in tax mat-


Banier with Bettencourt in 1992

PREVIOUS SPREAD: THIERRY ZOCCOLAN/AFP/GETTY IMAGES. THIS PAGE: ERIC ROBERT/SYGMA/CORBIS

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Set against teaspoons clinking on porcelain, the recordings include talk of tax evasion, nepotism, and backdoor contacts

ters involving Bettencourt while he was Budget Minister.

Bettencourt often sounds confused in the recordings, which include discussions with de Maistre, Banier, and a lawyer, Fabrice Goguel. In a recording made on May 11 of this year, de Maistre tells Bettencourt about his efforts to conceal the ownership of D'Arros Island in the Seychelles, where she was photographed with Banier, from French tax authorities. "Three or four years ago, you put D'Arros into a foundation," he says. "What island?" she asks.

The allegation of tax evasion is one of several threads in the scandal. Claire Thibout, a former Bettencourt family accountant, came forward in June to say that the heiress and her late husband routinely handed envelopes stuffed with cash to French politicians. "These gentlemen often came to get money," she said in a police interrogation report that was leaked to the press. Thibout has alleged that in 2007, de Maistre told her that he was giving €150,000 in cash to Eric Woerth to finance Sarkozy's Presidential campaign—20 times the limit for individual political contributions in France. De Maistre, Woerth, and Sarkozy have all denied that any such payment was made. In his television interview, Sarkozy said he was not close to the Bettencourts and had visited their mansion only two or three times, always as part of a group invited for lunch or dinner. "Can you imagine me coming to dinner, in front of the other guests, and leaving with money?" he said.

Thibout said she spoke out because she felt Bettencourt was being manipulated by her entourage—the same explanation given by the butler, Bonnefoy, who said he feared being fired because he had questioned Banier's relationship with his employer. The prosecutor's office in the suburb of Nanterre, where the Banier case is to be heard, has confirmed it has opened four investigations, one into alleged tax evasion and money laundering, another into alleged illicit campaign contributions, a third into Florence Woerth's work for Clymène, and a fourth into possible invasion of privacy involving Bonnefoy's recordings.

This could hardly come at a worse time for Sarkozy. Voters, frustrated with France's ailing economy and 9.9 percent unemployment rate, have turned on the once-popular president. With his reelection looming in 2012, Sarkozy has proposed what he hopes will be the biggest achievement of his term, an overhaul of the dangerously underfinanced retirement system. He has entrusted passage of the bill to Woerth, now Labor Minister.

Given his party's parliamentary majority, it's likely the legislation will pass. Still, the conversations in the Bettencourt parlor could leave an indelible stain. From the outset, Sarkozy's approach to political finance seemed refreshingly different—and was hugely successful. To prepare for the 2007 elections, Sarkozy and Woerth hired a professional fund-raising staff at the UMP and set up U.S.-style "donor circles." The party raised a record €9.13 million for the elections, while the rival Socialists raised only €750,000. The UMP's 400 to 500 biggest donors, known as the "Premier Circle," are invited to monthly receptions with party leaders at the elegant Hotel Bristol, across from the Elysée Palace. The President attends at least once or twice a year. One Premier Circle member who regularly attends the meetings argues that Sarkozy's decisions can not be bought for €3,000 or even €7,500, the maximum individual contribution. The donor declined to give his name.

Yet the accountant Thibout's statements—as well as her handwritten ledgers showing regular €50,000 cash withdrawals from the Bettencourts' bank account that she says were used partly to pay politicians—suggest that old habits may not have disappeared completely. Bonnefoy's recordings also include a conversation between Bettencourt and her lawyer Goguel about a private meeting she held with Sarkozy at the Elysée Palace to discuss the Banier case and its impact on L'Oréal. On the tape, Goguel says the meeting was "a very bad thing" because it encouraged the prosecutor to proceed with the trial. Even if the outcome was disappointing to Bettencourt, most ordinary French citizens can't get a private audience with the President. Spokesmen for the Elysée have declined to say whether such a meeting took place. In a July 14 statement, Liliane Bettencourt said: "I hope my daughter will not destabilize this group that my father and I wanted to remain French."

Worries about sale of the L'Oréal stake may be overblown. Bettencourt-Meyers, 57, who is already wealthy and serves along with her husband on L'Oréal's board, has said she is "deeply attached" to the company and has denied wanting to sell the family's holding to Nestlé. And even if she wanted to, Nestlé might not want to buy it. Although flush with $28 billion in cash, the Swiss company is focused on building its nutrition business. L'Oréal's cosmetics, shampoos, and hair colors aren't a natural fit.

For Sarkozy, though, the scandal's political risks are enormous. "There are new revelations every day, a loss of credibility," says Laurent Dubois, a professor at the Institute for Political Studies in Paris. "He doesn't have much maneuvering room." Indeed, a flash poll taken by survey group Ifop after Sarkozy's TV appearance found that 60 percent of viewers found his remarks on the Bettencourt scandal "unconvincing." Sarkozy's biggest challenge in dealing with the scandal may be to confront French voters' deep suspicions about wealth and privilege—"money that corrupts, that buys, that crushes," as Mitterrand once put it. "My God, I'm as suspicious of people who idolize money as of those who detest it," Sarkozy said in his June 12 interview. "Let's stop being so twisted about this subject. If I had been interested in money, I would have had a different career." Ⓑ

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How I Stopped Worrying And Learned To Short the Euro

Meet Andrew Law and his fraternity of global currency traders. Are they shameless speculators, an essential oil in the gears of capitalism—or both?
By Katherine Burton

In March, as his country teetered on the brink of insolvency, Greek Prime Minister George Papandreou blamed "unprincipled speculators" for exacerbating the crisis. Currency traders around the world were roiling markets, he said, and threatened to trigger a new global financial meltdown. He was talking about people like Andrew Law, chief investment officer of the $9 billion Caxton Associates, one of the best-performing hedge fund firms in the world.

What Papandreou saw as opportunistic speculation was all in a day's work for Law, 44. At the beginning of 2010, Law had a simple goal: to make money betting on global economic growth by shorting the euro and going long the rest of the world. He thought the Continent had problems that predated any impact he and his colleagues might have had. Currency traders make money betting on the movements of one currency against another. While other investors look at book value and price-to-earnings ratios, currency traders must stay abreast of political developments in every corner of the globe, translating tiny policy shifts or growth projections into profitable trading opportunities. At a time when many nations are in the midst of economic crises and concerns about sovereign debt are widespread, Law and other currency speculators can affect capital flows in and out of a country, driving up import prices and inflation, pushing stock and bond prices down, and causing a government's cost of borrowing to increase. The question is whether traders who bet on currencies are obstacles to a global economic recovery, as Papandreou suggests, or simply another set of actors making money—and making the market more efficient while they're at it.

Law believes that currency traders help resolve imbalances in the market.



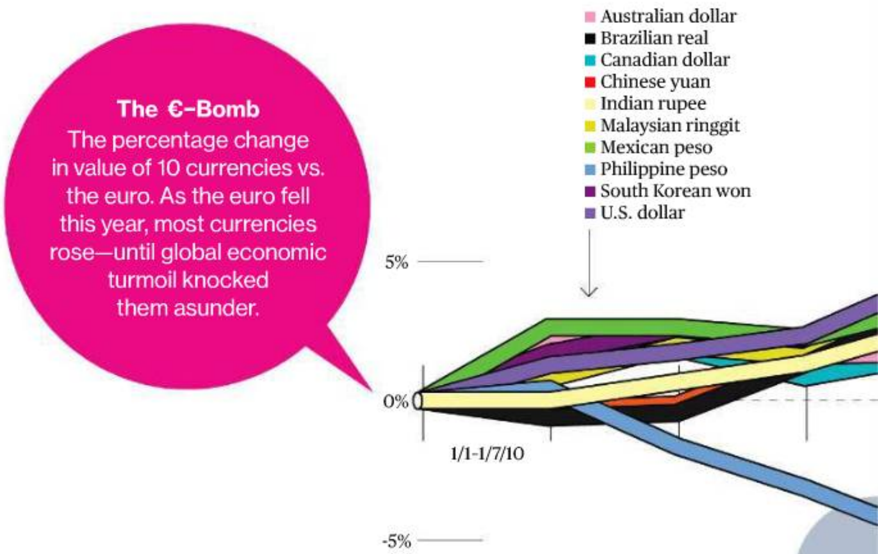
Percentage change in the value of the euro vs. the U.S. dollar, year-to-date

He simply wants to profit from his trades. "The driver of foreign exchange is having divergent outlooks for different countries," says Law, "and the fundamentals are pretty diverse at the moment."

Just as he was buying Canadian, Australian, and Asian currencies and pairing them against short positions in the euro, other traders were pairing those long investments with short bets against the U.S. dollar, which had weakened against the euro for much of the previous year. Law, however, was more concerned about Europe, after news that Greece's deficit was wider than previously reported. He wasn't sure how much higher the euro could go—it was then worth around $1.50, after climbing as much as 21 percent against the U.S. dollar in 2009. He saw the euro as the weakest link in the global currency market.

The 16 European Union countries that use the common currency had amassed too much debt. If investors began to view any of them as a default risk, the traders would start selling their bonds, stocks, and other assets, driving the currency lower. For the first five months of the year, foreign exchange trades were the largest bet in Caxton's main macro fund, and those trades were making the fund the most money. About half of Cax-

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ton's risk was from trading currencies, a higher-than-normal level for the firm that Bruce Kovner, who boasts one of the best track records in the hedge fund industry, formed 27 years ago. Law, who grew up in Cheshire, England, and is based in London, has been with Caxton for seven years. He was named Kovner's heir apparent in 2008.

Rarely have global economic conditions been so ripe for betting on currency fluctuations. Most traders agree they haven't seen such a difference between outlooks for different countries in at least a decade, and exploiting that gap is how currency speculators make money. Recovery prospects for the U.S. seem to be fading as employment fails to pick up, and Greece, Spain, and other European nations face massive deficits. At the same time growth prospects in Taiwan, Brazil, Malaysia, India, and Australia are so strong that policymakers have been raising interest rates to curb inflation. China has taken steps to deflate its real estate bubble and has let its currency drift higher for the first time in two years.

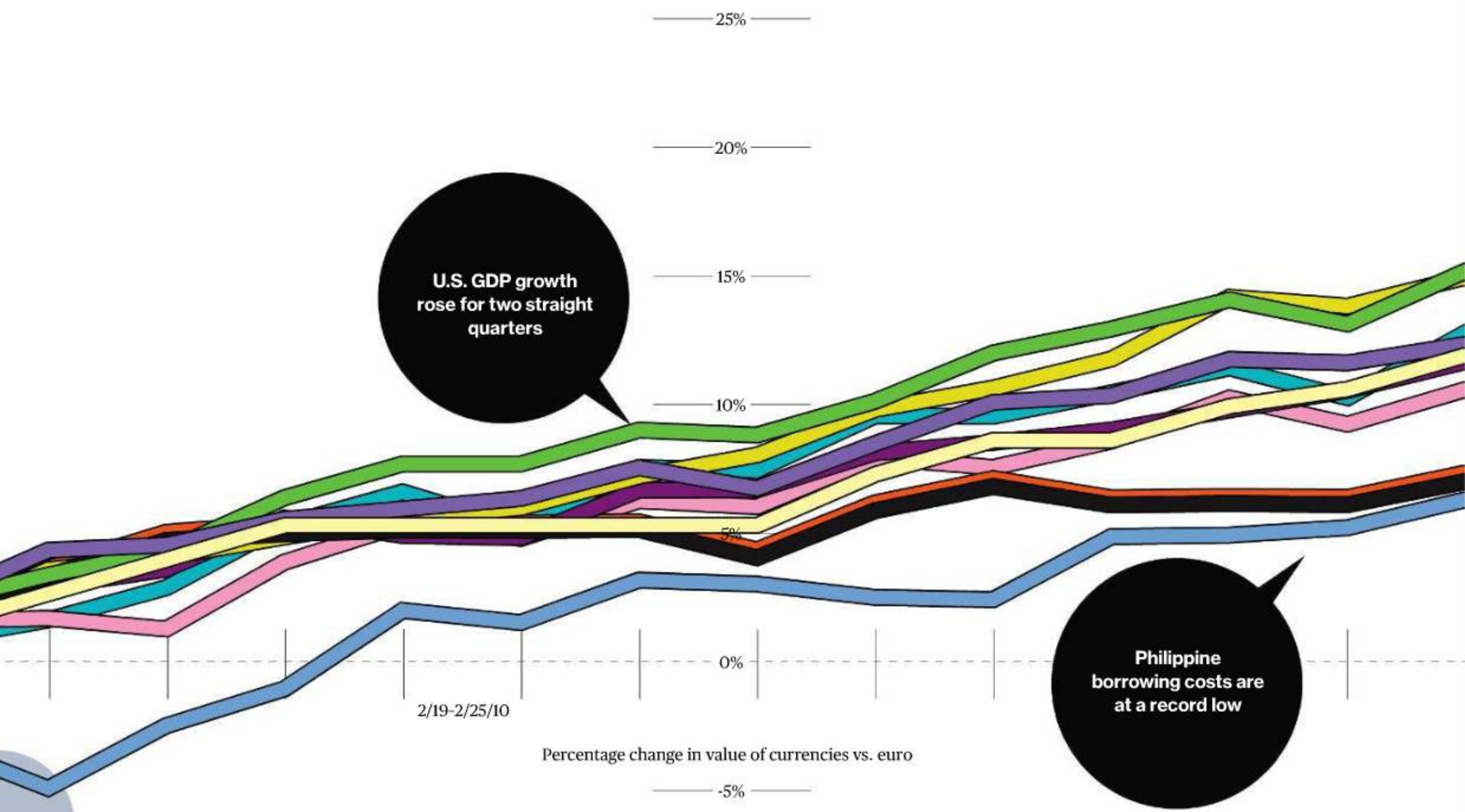
Currency traders are not overcaffeinated wild men barking orders on crowded trading floors; they're the self-contained types who have lunch with economics professors and carry the *Financial Times* tucked under their arms. The most famous of them all is the billionaire investor George Soros, who made headlines in 1992 for "breaking" the Bank of England when he shorted $10 billion worth of the British pound, which eventually led to the currency's devaluation. He and his lieutenant, Stanley Druckenmiller, earned $1 billion on the trade, but critics and politicians around the world who had seen their countries' currencies gyrating were not pleased. In 1997, Malaysian Prime Minister Mahathir Mohamad called Soros a "moron" who was out to destroy Asian economies. Soros' impact was so significant that in 1997 he made a point of refusing to speculate on the Russian ruble. "If I started to do some selling, the whole market would follow," he said in an interview at the time, "and it would have a bad effect on Russia."

The value of a currency is always relative. "That's why listening to the market is so important," Law says

On one level, what Soros, Law, and others like them do looks easy: A basic strategy is to buy into countries where interest rates are high and sell short those where interest rates are low, based on the expectation that capital will flow to countries where growth is strong and bond yields are high, thus pushing the currencies higher. In practice, though, the game is not so straightforward.

Like chess players, successful traders of currencies have to think several moves ahead–about what might prompt a central bank to raise or lower rates suddenly, for example. Decisions involve both political and economic variables, internal and external factors, and questions ranging from whether a rival political party might come into power to the possibility of a war erupting, which would cause investors to flee to the U.S. dollar–still seen as the safe currency. Currency traders don't deal with valuation in the same way that money managers who invest in stocks and bonds do. The value of a currency isn't absolute; it is always viewed in relation to one or more other currencies. "That's why listening to the market is so important," Law says. In addition to Caxton, Louis Bacon's Moore Capital, Paul Tudor Jones' Tudor Investment, and U.K.-based Alan Howard's Brevan Howard are major presences in the market. Law's boss, Kovner, who first made his name trading currencies in the 1980s, is

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seen as the grandfather of them all.

Most currency trades are done with forward contracts, essentially an agreement that a trader has made to buy one currency against another currency, generally one to three months in the future. Traders tend to construct their currency portfolios around a theme—a theory of where global markets are going and why—and hold their positions until the markets change. One peril of the field is high leverage: A hedge fund manager might put down as little as 2 percent for a forward contract, meaning that he has borrowed $49 for every one dollar in capital. If the market moves just 2 percent in the wrong direction, the trader's equity is wiped out. Risk has to be managed exceedingly carefully when a relatively small fluctuation can cause so much damage. As a result, profits can be elusive. Moore and Tudor both lost money in the first half of this year, while Brevan Howard is up about 0.2 percent. Caxton is doing the best, with a return of 4 percent, thanks in large part to Law and his bet against the euro.

The European currency started the year worth close to $1.50 but then tumbled below $1.20. Along the way politicians complained that hedge fund traders were driving the global economy into the gutter through their pursuit of short-term profits. Even the traders acknowledge that they've had some impact. "In the last six months, and for the next 24 to 36 months, what we do as a currency-focused macro fund is probably more relevant than it has been for at least a decade," says Howard Kurz, 53, who started Lily Pond Capital Management in 2001 and has been a foreign exchange trader since 1979. "The macro adjustments that are forthcoming are critical for rebalancing economies and allowing a transition from the vast accumulation of wealth in high-saving countries to increased savings in high-consuming countries." The result of that transition, he says, will be chronic slow growth around the globe.

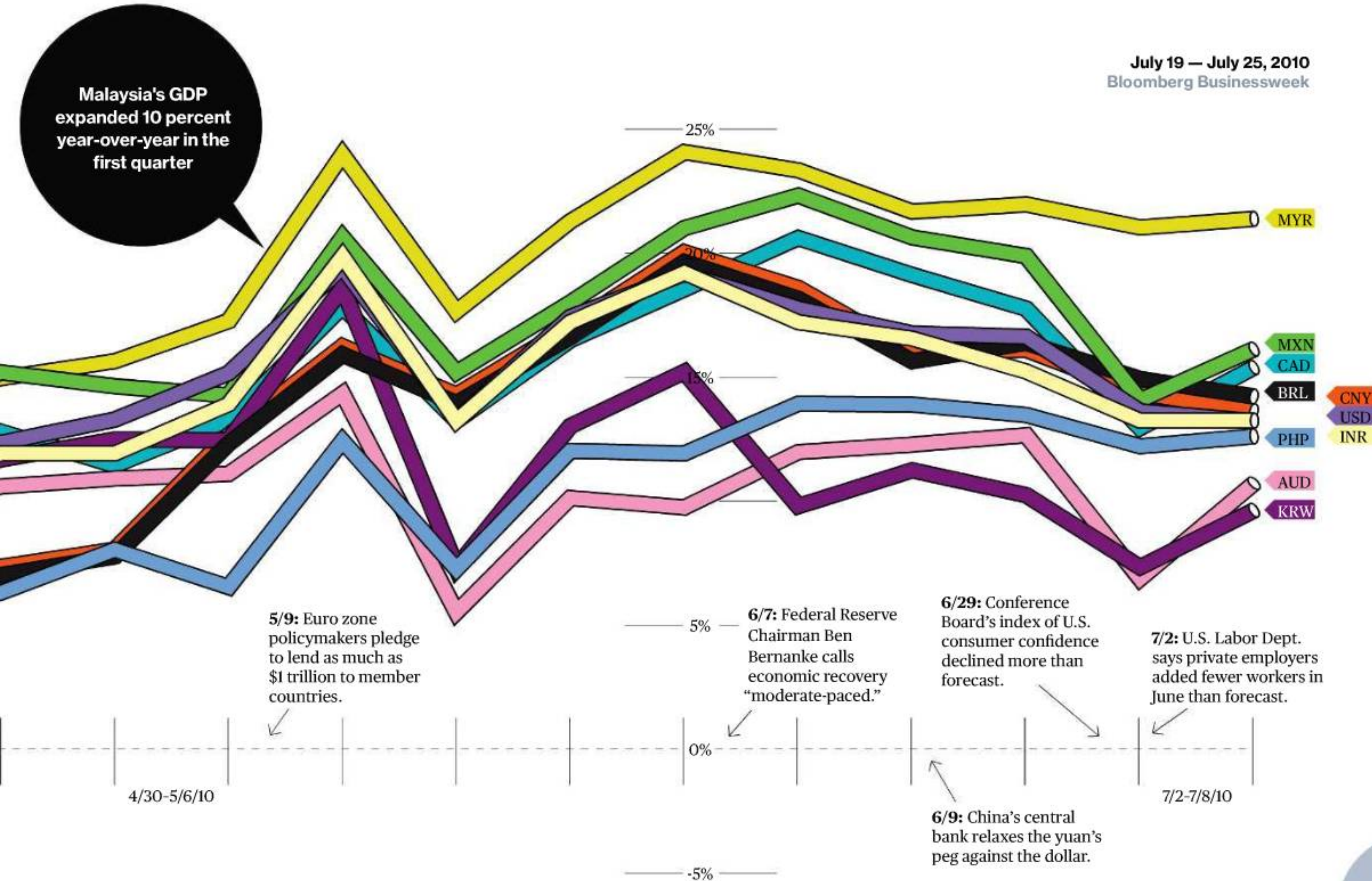
Volatility in currency markets is partly due to the lack of certainty among traders about what will happen in the next six months. Law says he and other traders know they can no longer count on the so-called Greenspan put, referring to former U.S. Federal Reserve Chairman Alan Greenspan's practice of cutting short-term interest rates at any sign of trouble. With low rates, consumers borrowed money to buy houses, televisions, and cars (and investors borrowed to buy stocks), all of which kept economic growth humming and the price of assets rising. Without this safety net, investors are skittish and uncertain about central bankers' ability to regulate economic cycles. Law says he has been reminded this year of a lesson that Kovner has often repeated: "Markets can move further than anyone can rationally predict, because no one has perfect foresight."

Law's willingness to retreat when markets move in ways he can't explain helped Caxton's main fund make money in May, when most others hit trouble. Midway through the month, the confluence of factors that had helped everyone take in profits—rising equities, strengthening currencies in emerging markets and commodity producing countries, rising oil prices—reversed in a matter of days and sent traders scrambling. Law sensed the shift coming the week of May 17 when the euro, which had been sliding for most of the year, stopped going down and global equity markets tumbled. When a correlation that has been consistent for months suddenly breaks down, Law says it's time to get out of the trade.

Through the early part of the year, the euro had been trading between roughly $1.32 and $1.38. Then on May 10

DATA: BLOOMBERG

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the European central bank announced a $1 trillion rescue plan for Greece and other debt-laden governments, and the euro slid toward new lows. Shortly after that the euro's plunge came to an end, and so did Law's winning trade. Between May 18 and May 21, the Mexican peso, the Indian rupee, the Brazilian real, the Philippine peso, and the Malaysian ringgit all fell about 4 percent against the euro. The Australian dollar tumbled 6.5 percent and the South Korean won more than 7 percent. The Standard & Poor's 500 Index lost almost 6 percent in four days, beginning May 17. "We listened to the markets, and on that day the markets were saying that the rest of the world would have weakness, so we got out of the way," Law says. "We reduced our currency trade over the next 24 to 48 hours."

Law's focus has now shifted to the U.S., where he is more likely to express his pessimism about the economy by shorting stocks. His biggest question for the second half of the year is whether private-sector demand is strong enough to withstand the inevitable winding down of the government's fiscal stimulus programs. What became apparent to Law in May, when U.S. stocks took a dive, were signs that the domestic economic recovery was not as robust as advertised. The S&P 500 has jumped 7 percent since the beginning of July, but Law is sticking to his view: "The theme of slower U.S. growth will likely be seen in equities." The euro, meanwhile, has climbed more than 6 percent against the dollar since hitting a low on June 7, in part because the EU demonstrated it has the will and the resources to bail out any member countries at risk of default. Plus, Law believes, Germany, which is the strongest European economy, seems committed to stimulating growth throughout the region. "What we are watching very closely is the behavior of the government debt markets in Germany and in the U.S. and how they trade relative to equities," he says. If both stocks and bonds start falling in tandem, that would be bearish for the growth outlook and bearish for equities, he says, as it would signal that Germany might not be able to bail out its weaker neighbors.

While Law worries about the American economy, Kurz of Lily Pond Capital is "slightly bullish" on the greenback because of its status as a reserve currency. Even so, he says a strengthening dollar isn't one of his big currency themes this year. Both Kurz and Law agree that everything depends on what governments do. "The best trades historically have come out of policy mistakes," says Law. (He points to 2008, when the European Central Bank raised rates in July, only months before Lehman Brothers declared bankruptcy, and then had to reverse course abruptly. Law was betting, correctly, that the central bank would have to cut rates.)

> **"The current period," Law says, "is not the same as anything we've seen in the last 25 years."**

Law is back to studying his charts, trying to find ways to squeeze out more profits. "The current period is not the same as anything we've seen in the last 25 years," he says. "What I've learned is that if you have a vision about where the world is going, and you manage to get into the trade at a good level, at the right size, and with the stop-loss in the right place, as long as the market continues to behave as I expected it to behave, then we keep the trade on." The smart speculator, however, knows his limits. "We can only point the ship in the right direction," Law says. "And then markets, fundamentals, policy will carry the trade on." B

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The summer's best boating trips Page 82

Shorts & Brazil & Yachting & $1,000 Pizza

Etc.



Lenny Dykstra, star player of the decade that was on Wall Street. Page 86



Welcome to Funkytown

With 70 percent of workers eating lunch at their desks, the office fridge has become the recession's latest victim. *By Eric Spitznagel*

Photograph by Fredrik Broden

FRIDGE: PHOTOGRAPH BY FREDRIK BRODEN FOR BLOOMBERG BUSINESSWEEK; DYKSTRA: BILL KOSTROUN/REUTERS/CORBIS

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Etc. Occupational Hazards



John Kiely, the owner of Allied Cleaning Service in Manhattan, has encountered more than his fair share of office refrigerators during 40 years in the business. "If you can wear a mask, sometimes you'll be O.K.," he says. "But sometimes the stench is just too much. It'll make you light-headed. I've actually been scared a few times. Now I know what a decomposing body smells like."

Anyone who's shared a refrigerator with co-workers knows the sensation. Take a peek inside your company's communal fridge, and you'll come across some of the most pernicious sights this side of a Roger Corman movie: Saran-wrapped tuna salad sandwiches that seem to have a pulse, leftover moo shu pork in the early stages of evolution, and cartons of half and half with the consistency of white lava.

There's always an excuse, of course. Kiely has heard them all. "My favorite is when they won't throw out a meal because it has sentimental value," he says. "Usually because it was made by their mom or a new girlfriend. I want to tell them: 'You know that new girlfriend you've got? I hope you're not thinking about marrying her for her cooking skills. Because let me tell you, her food stinks!' "

Office kitchenette horror stories have become noticeably menacing during the current recession; 70 percent of Americans, some likely looking to save money, are eating at their desks, according to an American Dietetic Assn. (ADA) survey of office workers. Longer lines for the break-room microwave increase the potential of soon-to-be-forgotten, bacteria-collecting leftovers in the fridge. This translates to increased health dangers. According to a study conducted by the ADA and ConAgra Foods, 44 percent of office refrigerators are cleaned once a month and 22 percent are cleaned only once or twice a year. Next time you're looking for a relatively bacteria-free place to store your lunch, consider that the bathrooms in your office are probably cleaner than the fridge.

According to the Agriculture Dept., the foods most likely to turn your office refrigerator into *The Hurt Locker* are casseroles, cold cuts, poultry, and the evil dairy twins: yogurt and sour cream. "One of the worst problems is food left in the fridge that everyone is encouraged to eat, like leftovers from an office meeting or group lunch," says Alice Henneman, a registered dietitian with the University of Nebraska-Lincoln Extension. "Who knows how long they sat out before they were refrigerated? I am aware of one company where over 30 people became sick because leftover food in a deep container didn't cool fast enough."

In some cases, decaying food is the least of the problem. Henneman, who has devoted much of her career to studying this occupational hazard, surveyed people on the worst things they'd encountered in office refrigerators. "The two scariest examples were human stool samples stored in the same refrigerator as employee lunches," she says, "and cow manure samples refrigerated next to food items."

She concedes that the stool samples "probably came from some type of company involved with laboratory procedures; there was no mention of any workers getting sick." Still, it's a precedent for anybody who's ever taken a long whiff of their office refrigerator and muttered, "What smells like crap in here?"

Co-workers who take it upon themselves to rid fridges of suspicious foodstuffs could be asking for trouble—physical and legal. Last year at an AT&T call center in San Jose, a helpful employee decided that somebody really ought to clean the company fridge. When she cracked it open, noxious fumes sent seven of her co-workers to the hospital and



"The two scariest [items seen in an office fridge] were human stool samples... and cow manure"

PHOTOGRAPHS BY FREDRIK BRODEN FOR BLOOMBERG BUSINESSWEEK

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forced authorities to evacuate the building. "It was like a brick wall hit you," employee Robin Leetieh later recalled about the stench. Guys in hazmat suits were called in to clean up the mess. In 2007, the University of Texas ordered the "aggressive cleaning" of a messy chemistry professor's office, including his personal refrigerator. The professor sued, and the 5th U.S. Circuit Court of Appeals came down in his favor. It ruled that all "government employees must receive adequate notice before their personal belongings can be tossed out." Including, apparently, their leftovers.

Do the same rules apply to your co-worker's long-forgotten and increasingly toxic tuna casserole? Dennis P. Ortwein and J. Stephen Kreglow, Pennsylvania trial lawyers who share an office fridge, don't think throwing out a fellow employee's tuna casserole is grounds for legal action. If an oversensitive co-worker does complain when his or her lunch cum science experiment has gone missing and threatens to sue, "the damages are probably nil," says Kreglow. "What is a moldy tuna casserole worth?"

Some companies are coming up with creative solutions to stave off such predicaments. Google and PepsiCo have introduced organic corporate vegetable gardens, where employees can harvest their own lunch rather than fill the break-room refrigerator with food they've brought from home and will inevitably abandon. Then there's the Stackable Office Fridge, the brainchild of a New York industrial designer named Spencer Schimel. Though it has yet to reach the manufacturing phase, this Lego-style stack of mini-refrigerators–which vary in size from 6 in. by 6 in. to 12 in. by 12 in.–could allow your co-workers to have their own individualized lunch storage space.

"An important problem addressed in my design, where I believe most of the problems stem from, is personal accountability," says Schimel. "Because the office refrigerator is unowned by any individual, no one feels responsibility to take care of it, and certainly no one wants to take time out of his or her busy workday to do so."

Schimel isn't the only industrial designer focused on the refrigerator problem. Denmark's Innovation Lab is working on a refrigerator that records its contents through a touchscreen interface and bar code scanner. You'll receive a text or e-mail when an item reaches its expiration date. South Korea- based designers Yoon Jung Kim and Jong Rok Lee have come up with a refrigerator that features a door that becomes transparent with the push of a button. For distrustful employees who want to keep their yogurt on them at all times, German designer Sebastian Bertram has come up with a design for a backpack fridge, which is exactly what it sounds like.

In the meantime, there are still fridges to be cleaned. According to Martin Friedman, the owner of Blue Chip Cleaning Services in New York, hosing down the office fridge is not necessarily part of their job description. "Our standard rate only includes the exterior of appliances," he says. "Not the inside of the fridge. If they want that included, we'll bill them with a separate invoice."

Friedman's pricing formula takes into account square footage, cleaning frequency, and "population density." If your company is willing to pay extra, Blue Chip cleaners will take a blitzkrieg approach to sterilizing the refrigerator. Everything goes, with extreme prejudice, for a cost of up to $5,000 per month. "Sometimes the customer asks us to empty out the entire refrigerator, wash everything down, and then sort through their stuff and put anything that's still edible back in," Friedman says. "We don't do that. We'll use common sense. If there's an unopened bottle of soda, that obviously goes back. Beyond that, we're not going to make a subjective judgment call. If it's in there, it's garbage." **B**

According to a recent study, 22 percent of office fridges are cleaned just once or twice a year

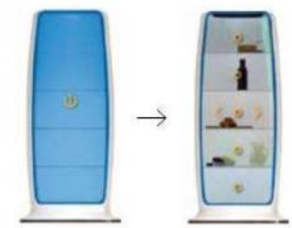
The Next Ice Age

Given the history of complaints about office refrigerators, it's remarkable how few technological advances there have been–until now. Though nearly all of these models are still in development, they could revolutionize lunch time as we know it.



The Stackable Office Fridge

Designer Spencer Schimel has come up with a bowling alley shoelocker-inspired product comprising small, individual fridges that will range in size from 6''x 6'' to 12''x 12.''



The Window Fridge

This fridge has an opaque glass door that becomes transparent with the push of a button. A rotating shelf allows for easy–and risk-free–inventorying.



The Boxcooler Backpack Fridge

The backpack uses "thermoelectric Peltier elements" to keep your food nice and chilly. Foldable cup and cutlery are molded into the tablet surface.



The Zero Emission Fridge for Rural Africa

This energy efficient fridge, designed by Mozambique farmer Gilberto Tethere, was created from bamboo and clay for rural communities.

ZERO EMISSION FRIDGE: ALINE GSELL

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Etc. One True Thing

Office Shorts

Show some leg without raising co-workers' eyebrows

The Want: Steamy summer weather calls for office-appropriate shorts that won't shock your colleagues. They must be easy to pair with a dressier top, long and loose enough to avoid questions about decency, and come in a fabric that looks formal and stays crisp at high temperatures.

The Women's Get: Rachel Comey's high-waisted women's shorts ($298 at farfetch.com) are made from a heavy silk that keeps its shape. Tailored but not tight, they look professional when paired with a tucked-in, short-sleeve blouse and a simple ballet flat. The deep orange color matches most neutrals and will transition perfectly into fall.

The Men's Get: Billy Reid's classic men's shorts ($155 at Billy Reid stores) have flat-fronted formality with a slightly edgy slim fit. The subtle black-and-white plaid (in a lightweight summer wool) adds character without being too bold. They look best worn with preppy basics, such as boat shoes and a crisp, sport-collar, button-down shirt. B —*Doria Santlofer*



Designer Rachel Comey studied sculpture and owned an art gallery before launching her eponymous label in 2001



Alabama-born, New York-based designer Billy Reid mixes classic Southern preppiness with an urban edge

SHORTS: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK

PERFECT PAIRS

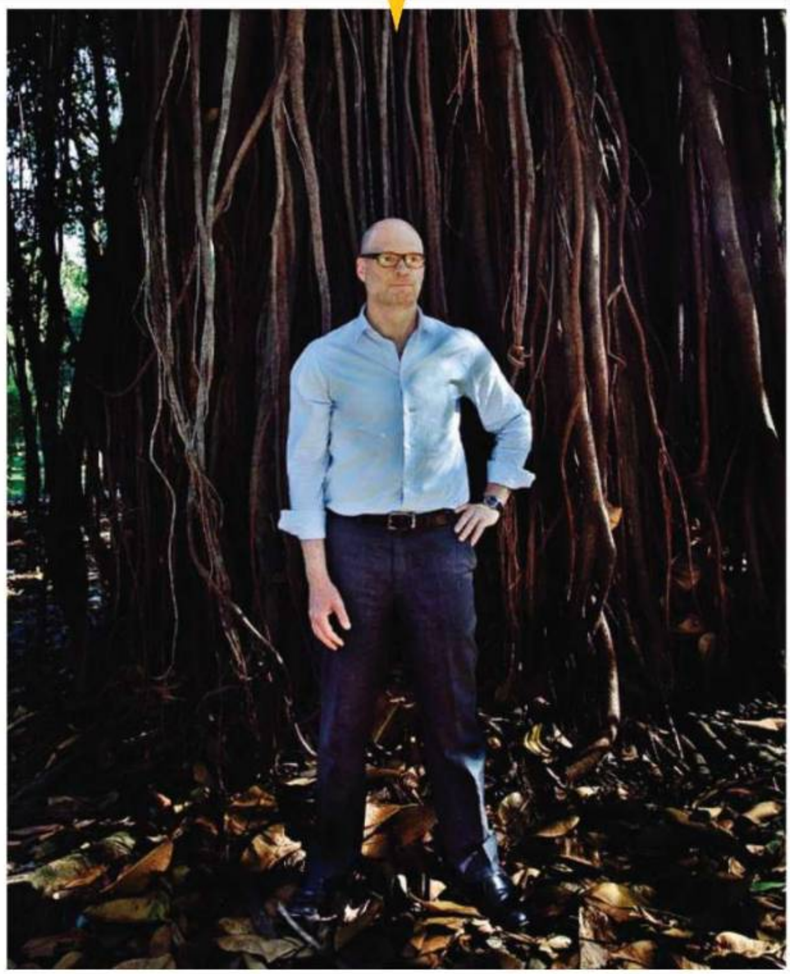
Shoes that work best with shorts

MEN	WOMEN
For work	
 **The Generic Man Naval Shoe** ($305) The slightly rounded toe and wooden heel seem formal, while the canvas top maintains a summery, low-key look.	 **Topshop Mazy T Bar Pearl Pumps** ($55) These flats' structured leather is topped by a pearl strap and grosgrain bow. They look pretty–yet polished–and go with every short.
For play	
 **Sperry Top-Sider** ($70) The fresh, neutral navy canvas works on the dock or even the golf course, depending on your after-work plans.	 **J. Crew's Demetra Sandal** ($198) In elegant gray leather, they have a cone-shaped heel that makes legs look slimmer and a comfortable elastic strap.

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Finding a Fortune In the Forest

Since starting The Forest Co. in 2007, Harald Orneberg has planted more than 1 million trees on his two Brazilian farms



A private equity player cashes out, then heads for Brazil to grow (money on) trees

When Harald Orneberg sold his private equity fund, ORN Capital, to British insurance giant Aviva in 2006, he became an indentured servant of sorts. As part of the deal, Orneberg was contracted to work for Aviva for a year, which turned out to be the longest year of his life. "Working for a large company," he says, "was like wading in molasses."

After fulfilling his contractual obligations, Orneberg, 47, decided to return to the business he had grown up around as a boy in Sweden: forestry. It was a decision facilitated by the rise of the Chinese paper industry, which was boosting pulp prices. Much more important, it was a field that had nothing to do with his previous career. "The rate of tree growing is independent of the financial markets," he says. "The tree doesn't know what is written in *The Wall Street Journal*. It doesn't even know that one day it may become *The Wall Street Journal*."

After hiring a consulting firm to find out which country had the best forests available for industrial use, Orneberg settled on Brazil, which had the highest tree growth rate and the most available land. In 2007 he formed The Forest Co. and, the next year, purchased two farms 560 miles north of São Paulo. Orneberg started planting pine and eucalyptus to supply the pig iron industry. The trees are used to make wood-based charcoal and are also sold as raw material to China, Russia, and the Middle East.

By spring of 2009, Orneberg had raised $50 million in investments–including $8 million of his own money–mainly from Nordic insurance companies and pension funds. This spring he closed on the next round: $126 million from European investors and church foundations.

Despite having only six employees, Orneberg is preparing for a $500 million initial public offering in Stockholm. In the meantime he's developing a resort community near one of his farms. After three years of almost constant travel, he's finally taking up residence in São Paulo. Although his life has hardly slowed down. "Things are so intense in São Paulo that I have to go to New York to chill out," he says. Ⓑ

—*Alexandra Wolfe*

A eucalyptus tree can grow more than 100 feet in its first seven years



THE PAPER CHASE

$50 m
Cost of buying farmland and raw materials; $8 million came out of Orneberg's own pocket

$1,100
Cost of planting an acre of pine and eucalyptus trees on Orneberg's two farms

25,000
The total number of acres of trees planted every year by The Forest Co.

7
Number of full-time employees, including Orneberg, at The Forest Co.

DATA: THE FOREST CO.

ORENBERG: PHOTOGRAPH BY KIM BADAWI FOR BLOOMBERG BUSINESSWEEK; TREE: PHOTOLIBRARY/CORBIS

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Boating

A personalized guide to a vacation on the water



Newport's Chanler at Cliff Walk hotel dates back to 1873



Oasis of the Seas is the world's largest cruise ship

1. The Mogul



Newport, R.I.

For those who wait all year to slouch into a gold-buttoned navy blazer, slip on boat shoes, and entertain clients or family on a classic American sloop, here's the best way to sail from New York City to the nautical heartland of Newport.

THE YACHT: ***The Mariner III,*** a 1920s-era, 122-foot boat that has drawn celebrities (John Barrymore, Madonna, Harrison Ford) with gilded teak-paneled staterooms. The six-person crew can host up to 80 guests. Depart New York's Chelsea Piers around 8 a.m. to reach Newport in time for sunset cocktails ($4,500 for a day trip, $8,000 per night). STAY: If you're not in the water, see it in all its splendor from the 20-room **The Chanler at Cliff Walk** hotel. Book the plush Nantucket Ocean Villa (around $1,000 a night) for private gardens with panoramic Atlantic views. EAT: Meaty, fresh No-Nonsense Lobsta Rolls at **Flo's Clam Shack** have been the perfect Newport nosh since 1936. DRINK: New Englanders began guzzling Narragansett Draft Lager in 1890; have yours at **Midway Bar,** an alfresco people-watchers' paradise at the 18th century **Clarke Cooke House**. SHOP: Before embarking from Manhattan, stop in SoHo's **Opening Ceremony** boutique to buy a pair of limited-edition, retro water shoes ($95) inspired by Timberland classics. SEE: Get your fill of maritime history at the **Museum of Yachting**, which is restoring the 133-foot *Coronet* schooner, built in 1885. TIP: Fans of rope-and-buoy-inflected decor will love the **Newport Yachting Center's Arts Festival**, Aug. 28-29.



2. The Family



Eastern Caribbean

One key to bringing the brood together is being able to spend time apart. For all their flaws, cruises balance family and free time: You'll find activities aplenty—and containment that eases (some of) your worries about the kids.



CRUISE: Gargantuan and enjoyably over the top, **Royal Caribbean's *Oasis of the Seas*** is a 100,000-ton floating resort with a shady park, zip line, surfing simulator, ice rink, boardwalk, four pools, and a massive, slow-moving elevator that doubles as a bar. The **Eastern Caribbean Cruise** option (from $750 per person for seven nights) sets sail from Ft. Lauderdale and affords full days in Nassau, St. Thomas, and St. Martin, which means at least 24 hours on turquoise-water-fronted white sands. STAY: The Royal Family Suite (from $1,750 per person for seven nights) sleeps eight. EAT: Send the kids to **Johnny Rockets** and try **150 Central Park**, with its seven-course menu and expansive wine list. Reserve well in advance. DRINK: Perched on the boat's 17th deck, **Viking Crown Lounge** has a view that's worth the hike. SHOP: On St. Thomas, pick up colorful quadrille dancer dolls ($39-$64) at the **Native Arts & Crafts Cooperative**. SEE: Sign the family up for the cruise's **Voluntourism Program at St. John Virgin Islands National Park**. You'll be picked up at St. Thomas and spend a day fixing jungle trails or cleaning beaches. TIP: Rent iPhones ($17.50 per voyage) through the **Royal Connect** program to avoid hefty roaming charges and track the kids'—or Grandma's—whereabouts.

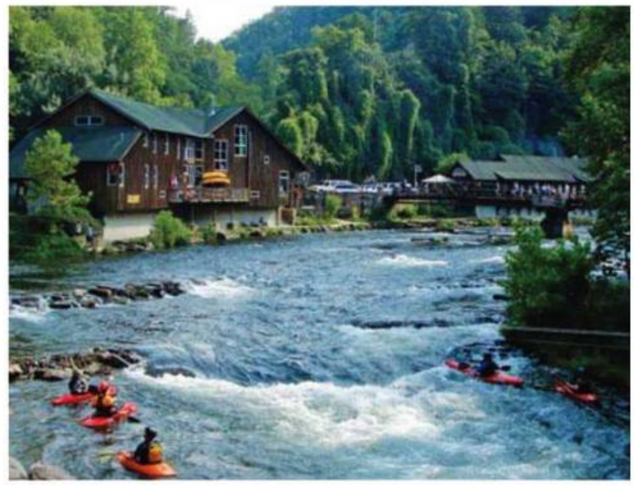
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The Olympic Circle Sailing Club has a 50-boat fleet



Top kayakers teach at Nantahala Outdoor Center

3. The Twenty-something



San Francisco Bay Area

Neither too remote nor too trafficked, the Bay Area is ideal for those who couldn't bear to be *too* far from it all: In Berkeley Harbor, you'll get epic wind, choppy waters, and access to San Francisco's locavore bistros and stylish bars.

SAIL: In Berkeley, **Olympic Circle Sailing Club** offers a "Learn to Sail" course ($995 for two weekends or five weekdays); graduates are able to singlehandedly skipper a small boat. STAY: You're better off crossing the bridge to sleep in San Francisco, where the design-focused **Clift Hotel** sits within steps of quiet, storied Nob Hill. It remains popular for its surreal Philippe Starck lobby, sceney bar, and mod rooms (from $285 per night). EAT: The menu is entirely seasonal at **Frances**, an already acclaimed new Castro neighborhood spot with a young chef, Melissa Perello, who scours Northern Californian farms for fresh ingredients. DRINK: Sip a cucumber gimlet at **The Owl Tree**, a dive bar turned swanky cocktail spot (with only a few owl-influenced touches) a few blocks from the Clift. SHOP: Sailing? There's an app for that: **iNavX Marine Navigation** ($50) has all the charts you'll need to navigate U.S. coastal waters. SEE: Arrange to have your lesson on the weekend of July 31 to catch the **22nd Annual Berkeley Kite Festival**, which also benefits from the city's gusts. TIP: Avoid seasickness by popping a few ginger tablets (try **GNC Natures Fingerprint Ginger Root**) before setting sail.



4. The Landlubber



Bryson City, N.C.

If the mere thought of sailing makes you seasick, head to Bryson City, where three of the nation's great rivers drain out of the Smoky Mountains. It's a whitewater paradise, 400-year-old forest, and quaint town all in one.

PADDLE: Kayak lessons ($99 per person for a one-day course) at **Nantahala Outdoor Center** include gear, a picnic lunch, and tuition from champion paddlers. STAY: **Watershed Cabins** is nestled amid poplars at the top of a windy mountain road. Reserve the Moonstruck (from $215 per night), a grand log-and-stone cabin with a hot tub, outdoor fireplace, and gorge views. EAT: After a long day in the kayak cockpit, savor wild mushroom fritters and brook trout (known locally as "specks") at **Reila's Garden**, a literal stone's throw from the river. DRINK: Sample Nantahala Brewing Co.'s Noon Day IPA at **Across the Trax**, a woodsy joint loved by travelers and townies alike. SHOP: The **NOC Gear Shop** peddles activewear like Vibram's Fivefingers Sprint, waterproof shoes made to mimic bare feet. SEE: In **Smoky Mountain National Park**'s western wilds, large stands of old-growth forest are preserved above Appalachian-settlement ruins on the upper reaches of Noland Creek trail. TIP: Flying in and out of **Asheville Regional Airport** instead of Atlanta or Charlotte saves you four hours in the car, round-trip. Direct flights come from 10 cities, including Chicago, Houston, and New York (a round-trip from O'Hare costs upwards of $370). B —*Alex Pasquariello*



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LEW ROBERTSON/GETTY IMAGES

Strategies for Capitalizing On Alternative Assets

High-net-worth financial adviser Louis Stanasolovich on how to hedge your bets

We are in one of the ugliest periods in history. The economy is incredibly weak. The government is going to print money to fund enormous deficits for the next three to five years, and after a period of deflation we'll have severe inflation around 2015.

To survive as an investor in such a volatile environment, you need to have a very flexible thought process. In a low-growth economy, you are not likely to have a high-growth investment world. If you buy and hold U.S. equities and bonds for the next decade, you'll probably get a 6 percent return on equities and maybe 2 percent on bonds. This is where alternative investments come in. Alternatives like managed futures are going to get you around a high single-digit or low double-digit return. Managed futures funds can invest in everything–stock indices, bond indices, currencies, interest rates, metals, energy, and agriculture. They can be long or short almost any benchmark. They can play very short-term trends, and they don't move similarly to the market. That flexibility makes a lot of sense in a volatile market.

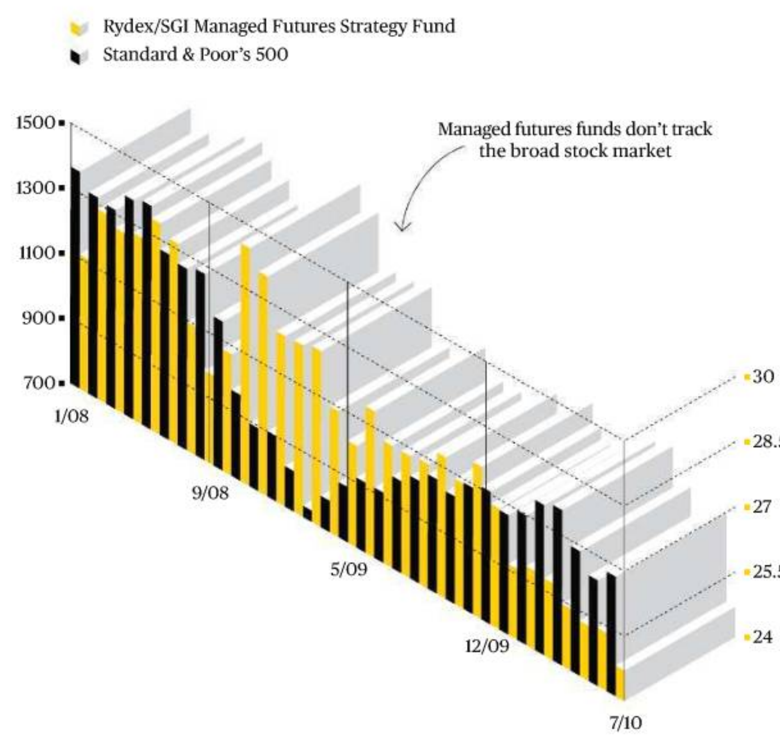
I recommend investors have 5 percent to 10 percent in these funds. There are a few mutual funds that invest in managed futures this way, such as the Rydex/SGI Managed Futures Strategy Fund that came out a few years ago. And now there's the AQR Managed Futures Strategy Fund.

A lot of new alternative mutual funds have high charges. We're O.K. with that if the strategy works. We look at the additional cost as the cost of insurance. You have to judge whether that additional expense over a Standard & Poor's 500-stock index fund is worth it. For instance, we use the Merger Fund and the Arbitrage Fund as a replacement for a portion of our equity strategy. Their expenses are higher, but they've outperformed the S&P 500 by 5 percent or 6 percent per year over the last decade.

The problem with many newer long-short funds is that they are, for the most part, long only. They use some shorting to temper the downside but not enough to prevent the downside, so some fell as much as 40 percent in 2008. The long-short fund we like the best is Caldwell & Orkin Market Opportunity Fund. It usually is negatively correlated to the market, so as a portfolio component I give it five stars because it stabilizes your portfolio. It's had some phenomenal years when the market has been negative and also some good years in the 1990s when the market was up.

A STANASOLOVICH FUND FAVORITE VS. THE S&P 500

Managed futures can take advantage of short-term market trends



DATA: BLOOMBERG

The problem with many newer long-short funds is that they are, for the most part, long only

We also recommend investors replace half their bond investments with funds such as the Eaton Vance Global Macro Absolute Return Fund, which can invest in bonds all over the world and go long or short currencies as well as invest in derivatives. The steadiness of the return of that fund has been awesome. —*As told to Lewis Braham*

The Stats: Louis Stanasolovich is founder of Legend Financial Advisors, an investment advisory firm managing $380 million. He is also editor of *Risk-Controlled Investing*, a monthly newsletter focused on alternative low-risk investment strategies, and a co-founder of The Alpha Group, which manages more than $4 billion.

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Etc. The Stack

Despite his critiques, Lane was as hungry for money as his subjects



When Greed Was Good

The *Trader Monthly* co-founder offers a gossipy recollection of a bloated decade. *By Ian McGugan*

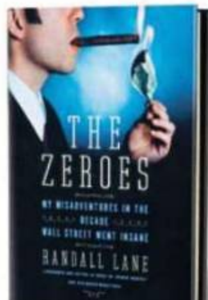
Nearly a decade ago, former *Forbes* bureau chief Randall Lane spotted the beginnings of a new culture devoted to the notion that 26-year-olds with a gift for swapping financial assets could be able to make as much in a few months of trading as an average person makes in a career. Lane launched a series of magazines devoted to glorifying this culture—publications with names like *Trader Monthly* and *Dealmaker*—that specialized in stroking the emerging plutocracy of hedge fund managers, traders, and private equity speculators.

Lane believed he would make his own fortune by giving luxury advertisers a forum to reach this small but growing mob of ultrarich arrivistes. Unfortunately he chose a medium that would prove to be a surefire prophylactic against profits. Despite zealously attempting to sell out, Lane couldn't make a buck. When stock markets collapsed in 2008, so did his publishing empire.

i

The Zeroes: My Misadventures in the Decade Wall Street Went Insane

by Randall Lane
PORTFOLIO,
359 pp, $27.95



At least he got a great story out of it. His new book begins by sticking a snazzy label—the Zeroes—on the decade just past. It then proceeds to trash most of the people that Lane spent the Zeroes glamorizing. If you want to know what hedge fund managers consider "a proper night out" (translation: a $10,000 excursion to an upscale strip club), this is the book for you. Ditto if you're looking for the nasty on John Travolta or Lenny Dykstra, the baseball star-turned-financial-impresario.

As Lane tells the story, he was the guy in the frayed suit, with the dented '97 Subaru Outback, trying to make his way in the world of the superrich, all the while casting a skeptical eye on their rituals of conspicuous consumption. While the Wall Street crowd dined on $175 Kobe beef burgers, Lane chowed down on a tub of Costco peanut butter. While hedge fund managers dropped tens of millions on gated-and-walled family compounds in Greenwich, Conn., Lane and his wife and two daughters endured a cramped apartment in Manhattan, where the kitchen doubled as the office.

So endless are Lane's assertions of his rela-

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tive poverty that it's easy to miss that he was just as hungry for money as anyone else. If things had turned out differently, and Lane's publishing endeavors had gushed profits instead of bled red ink, his ethical sensibilities might not have been so offended by the thought of the $1,000 lobster-and-caviar pizza at Nino's Bellissima. Heck, Lane probably would have enjoyed a slice himself.

Perhaps as a result, *The Zeroes* is marvelously readable, and also misleading. As Lane deplores "the kind of greedfest that comes along only once every thousand years," most readers will be led to conclude that the financial meltdown was the result of an unprecedented outbreak of heretofore unknown avarice on Wall Street.

There are a couple of problems with this glib moralizing. The first is that we've heard it too many times before. After every financial crisis, whether it be the junk-bond collapse of the late 1980s, the dot-com bubble of the '90s, or the 2008 financial crash, there are books (often by Michael Lewis) blaming the collapse on Wall Street's uncontrolled lust for money. The purported evidence for this chain of causation goes something like this: Before the economy cratered, financiers were demonstrating unmistakable signs of greed. Ergo, greed caused the crash.

What this glib explanation misses is that greed isn't a variable in the markets–it's a constant. The traders and hedge fund managers that Lane captures so well in his book are a grasping, materialistic lot, devoted to buying flashy watches and expensive rides–and so were their predecessors, going back to when the stock exchange was founded under a buttonwood tree. If you're going to indict this long line of greedy so-and-sos for causing financial crashes, you also have to credit them with all the intervening periods of prosperity. No historian of Wall Street has ever detected an Age of Altruism.

Lane attempts to draw a line between Wall Street's present and its past–"when it was a well-paying career providing the lifeblood of capitalism, rather than an absurd casino promoting perilous, systemic risk"–but the distinction doesn't hold for a number of reasons.

Probe Wall Street's history and you turn up various characters ranging from Jay Gould to Joe Kennedy, all of whom made fortunes with then-legal scams that would have landed them in jail today. By comparison, the traders and hedge fund speculators that Lane pursued so avidly in the Zeroes wind up looking, on some levels at least, like surprisingly decent folks.

Many of them–the "quants"–held advanced degrees in math or physics. They showed up in laughably large numbers for charity events. Steve Cohen of SAC Capital Advisors, the reigning king of the traders during much of the Zeroes, didn't squander the hundreds of millions he earned on chasing women or racing fast cars. He spent his money collecting Picassos and Pollocks. (Why, the effrontery of the man! That sounds nearly ... tasteful.)

In attempting to make the case that the past decade constituted a bacchanalia of greed, Lane's strongest evidence is the spiraling salaries of the financial elite. Midway through the Zeroes, top traders and dealmakers were earning amounts that made a successful career in, say, cardiac surgery or corporate law look like a sucker's bet.

Lane could hardly believe the amounts reported in his company's annual list of the top 100 traders: By 2004, a trader needed to earn tens of millions of dollars a year to be considered in the upper tier. At the top of the list were people such as Cohen and James Simons, of Renaissance Technologies, who were taking home around half a billion each.

Lane suggests these salaries were sure signs that Wall Street had lost its sanity. He implies that such superabundance must be followed by an inevitable crisis. In discussing the compensation of most hedge fund managers, he fumes that "the most ridiculous pay scale ever devised came into widespread acceptance at the exact same time that

Did the Zeroes really represent the kind of greedfest that comes along only once in a thousand years?

Heroes of the Zeroes

From his perch at *Trader Monthly*, Randall Lane covered some of Wall Street's biggest and unlikeliest players. Along the way he also developed a number of favorite subjects that populate the pages of his book, *The Zeroes*. —*Spencer Bailey*

Stephen Schwarzman
The Blackstone CEO is described by Lane as the "king of private equity" and the "poster child of decadence." This despite his "salt-and-pepper comb-over appropriate for a man soon to turn 60."

John Paulson
The executor of one of the greatest trades of all time gets little love from Lane, who writes: "For all the sparkle of his wealth, he had the charisma of an accountant."

Lenny Dykstra
The scrappy outfielder turned bloated derivatives guru collaborated with Lane on a glossy financial advice magazine catering to pro athletes. According to Lane, Dykstra's "wanton spending" scuttled the project.



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James Simons
The Berkeley PhD, says Lane, stayed "true to his alma mater, lost his job with the Defense Dept. for opposing the Vietnam War" before making billions through his fund, Renaissance Technologies.

Steve Cohen
Dubbed "the Greta Garbo of the markets," "a freak of nature," and "the fleece-clad queen bee," Lane says Cohen "represented everything to aspire to." By which he meant oodles of money.



electronic trading turned the entire world into a free-for-all global casino."

Really? Pro athletes also earn far more than they used to, but Eli Manning's $98 million contract doesn't mean that the NFL has lost its mind, or that it faces collapse, or that it has turned itself into a crap game. What seems more likely is that both athletes and traders have benefited from a cluster of lucky breaks that have put them—at least temporarily and probably undeservedly—at the sweet spot of the economy.

Thanks to television and the Internet, athletes can cater to larger audiences and capitalize on many more commercial tie-ins than previously. Thanks to electronic trading, 24-hour global markets, and larger and larger pools of mobile capital, traders can move more quickly and in larger volume than they ever could before.

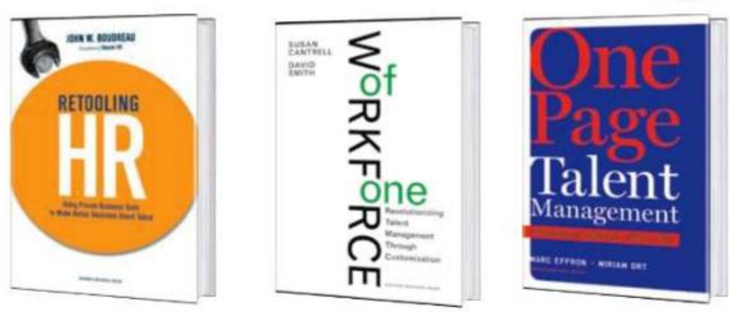
None of this is to deny that there were problems with banks and with the financial system during the Zeroes. But suggesting that traders' unprecedented incomes were the result of some type of fundamental moral breakdown just seems too easy.

During the Zeroes, Lane thunders, "Wall Street's breathless pursuit of zeroes, that easy-money mentality, had permeated every aspect of our culture." Wall Street and the larger culture have always been money-mad. All that happened during the Zeroes was that we discovered ever more elaborate, high-tech ways to amplify our same basic avarice. Sure, billionaire traders felt the greed—but then so did peanut butter-eating magazine publishers. B

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Etc. Hard Choices

Sung-Joo Kim

"It's hard to get respect as an Asian woman running a fashion business. These European guys look at me like I don't belong"

Sung-Joo Kim, founder of Sungjoo Group and chair of MCM Group, on being disowned by her family and becoming an entrepreneur



My father is the founder of Daesung Group, one of the biggest energy companies in Korea. I'm the youngest of six children and one of three girls. My job was to grow up and marry a rich man.

I went to Amherst and later Harvard, where I started dating a Canadian. When I asked him to marry me, I was disowned by my family. I dropped out and got a job at Bloomingdale's. My parents wouldn't talk to me. I had gone against their wishes, and there's nothing worse in Confucian tradition.

I accepted that I had failed them. But eventually my father reached out to ask me to help translate a negotiation when Daesung entered a joint venture with Bendix. They started arguing over who would be CEO. I stepped in–and the deal got done.

Later, my father asked me to his office to see if I needed anything. I asked for a $300,000 loan to start my own fashion business. I bought the Korean rights to Gucci and brought Marks & Spencer into Korea. I also became the licensee for a German luxury goods company called MCM Group.

By 2005, MCM was struggling. When it started to fail, I had a choice: I could move on, or I could own it. The business model was a disaster. My brothers were against me. But the artisanship was there, and I saw that the products could be better. Korea was opening to trade, and I didn't want to sit and wait for someone to come and get me. So I bought the whole company.

Even today, it's hard to get respect as an Asian woman running a fashion business. These European guys look at me like I don't belong. Yet it's Asian women who are buying luxury goods today.

My father, when he passed away in 2001, divided his company between my three brothers. At our last lunch together, he asked me for forgiveness for some of the things he had done. I told him that a lot of what I had learned about doing business I had learned from him. I didn't want his money. I wanted to show what a woman could do. Ⓑ

—As told to Diane Brady

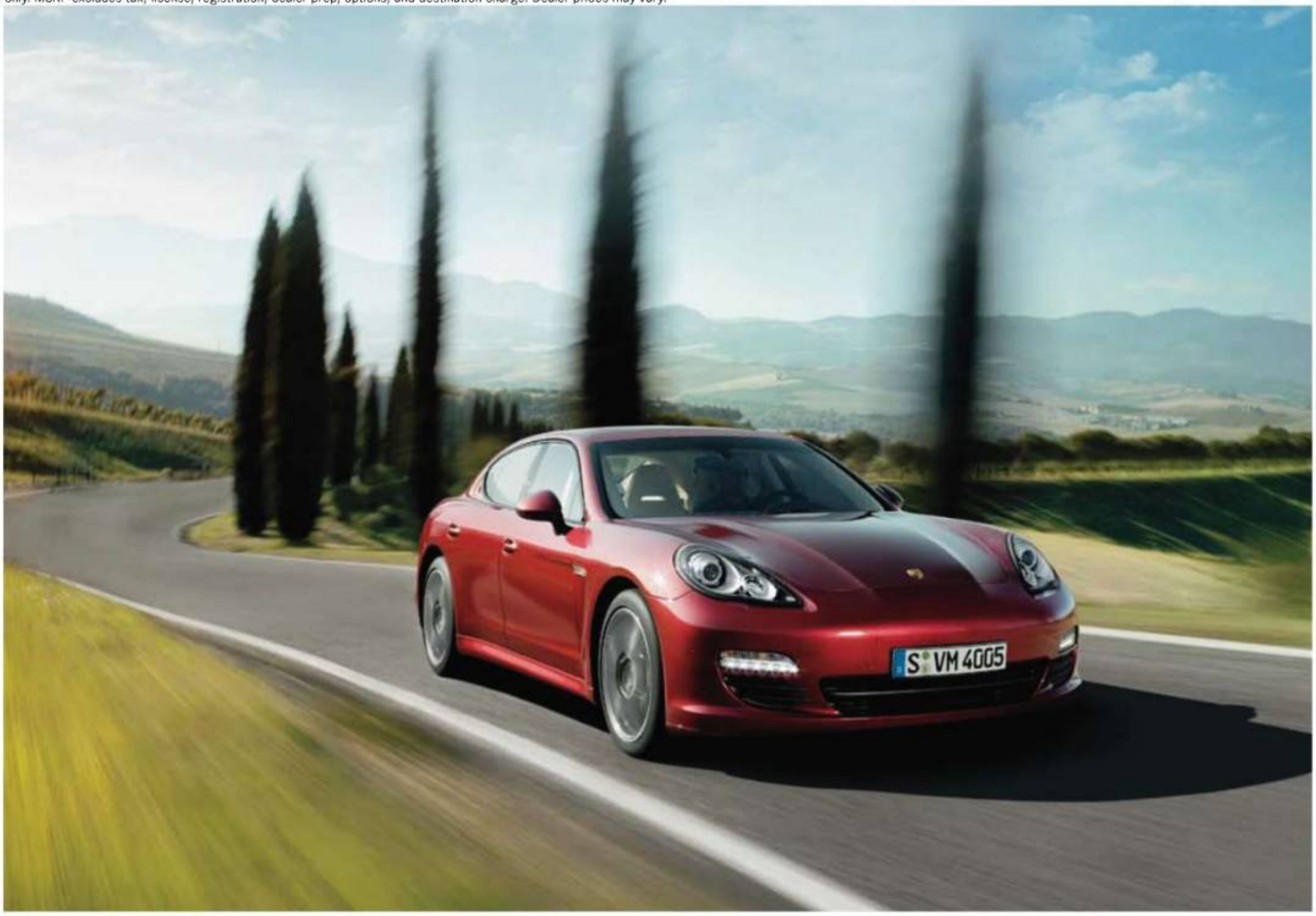
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